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# COMMITTEE ON WAYS AND MEANS
# U.S. HOUSE OF REPRESENTATIVES

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# MANAGING UNITED STATES-KOREAN TRADE CONFLICT

A SEMINAR SPONSORED BY THE WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS, THE CONGRESSIONAL RESEARCH SERVICE OF THE LIBRARY OF CONGRESS AND THE COMMITTEE ON WAYS AND MEANS, HELD MARCH 31, 1987

SEPTEMBER 21, 1987

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COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC 20515

SUBCOMMITTEE ON TRADE

March 9, 1987

Mr. Joseph E. Ross, Director
Congressional Research Service
Library of Congress
203 Madison Building
Washington, D.C. 20540

Dear Mr. Ross:

This is to request that the Congressional Research Service conduct a conference on U.S. trade relations with South Korea, in conjunction with the Subcommittee on Trade and the Woodrow Wilson Center of the Smithsonian Institution.

As you know, trade legislation is a top priority of the 100th Congress. An important component of the debate will be the U.S. trade and economic relations with the newly industrialized countries of East Asia. (South Korea now ranks as the seventh largest trading partner of the United States, and the United States ran a deficit of $7 billion in 1986.) This program will provide the Committee an in-depth and scholarly review of the current U.S.-Korean bilateral trade and security issues, and will directly supplement our legislative work on the omnibus trade bill.

My staff has been in contact with analysts of the Foreign Affairs and National Defense Division and the Economics Division concerning the structure of a conference. They have suggested a workshop-type conference with a daytime session conducted by the Congressional Research Service and an evening session conducted by the Woodrow Wilson Center. The format would be similar to the conference the two organizations held on the Philippines in February 1986, just prior to the Philippine presidential election. They have tentatively decided on March 31 as the most convenient date. As the sponsor of such a conference, the subcommittee would provide recording services and would publish the proceedings as a committee print.

Your action on my request will be greatly appreciated.

Sincerely,

Sam M. Gibbons
Chairman

SMG/fp

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# MANAGING UNITED STATES-KOREAN TRADE CONFLICT

TUESDAY, MARCH 31, 1987

HOUSE OF REPRESENTATIVES, THE WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS, AND THE CONGRESSIONAL RESEARCH SERVICE, COMMITTEE ON WAYS AND MEANS,

*Washington, DC.*

The workshop met at 10:05 a.m., in the east dining room, sixth floor, Madison Building, Library of Congress, Stan Heginbotham and Larry Niksch (of the Congressional Research Service) presiding.

STANLEY HEGINBOTHAM, CHIEF, FOREIGN AFFAIRS AND NATIONAL DEFENSE DIVISION, CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS

Mr. HEGINBOTHAM. My name is Stan Heginbotham. I am Chief of the Foreign Affairs and National Defense Division at the Congressional Research Service. On behalf of Joe Ross, the Director of the Service, who is unable to be here this morning, I am delighted to welcome you to this seminar on managing United States-Korean trade conflict.

There are a number of appropriate things about the setting and timing of this meeting. I think it is appropriate and symbolic that we should have tempestuous weather outside with moments of severe downpour with the sun attempting, from time to time, to find its ways through holes in the clouds.

I think it suggests the character of a difficult and very important period in the evolution of United States-Korean relations.

I think this gathering reflects the dual character of the problem in being both a political and an economic problem. I think the schedule for today's section reflects that.

I think it is appropriate that the setting be a congressional one because Congress is, I believe, acutely conscious of and attempting to cope with both the politics and the economic and the diplomacy of the situation.

So I am delighted with the gathering, with your presence, and with the fine set of speakers and panelists that have been assembled for today's events.

We are delighted to be able to cosponsor this event with the Woodrow Wilson International Center for Scholars, and I would like to take a moment to introduce Ron Morse, who is head of the

Asia program at the Woodrow Wilson Center and to ask him to say a word or two, if he would like, of welcome as well.

RONALD A. MORSE, SECRETARY, ASIAN PROGRAM, WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS

Mr. MORSE. We're just happy to cooperate again with the Foreign Affairs Division. We've done it three times now, once before the Philippines elections, and once in 1982, when people were interested in Japanese decisionmaking, but they did not read the final report too carefully. Hopefully, they will get a lot more out of this round.

We have worked together three times like this, and it is mutually beneficial. So we are happy to cooperate again. We have got a couple of speakers who came all the way from Korea. So I think we have got a good group of people that let the Koreans speak about Korea and let the Americans speak about America and see what we can come up with together.

Thanks, Stan.

Mr. HEGINBOTHAM. Bill Robinson, the Deputy Director of CRS, has been here. I do not see him right at the moment. If he comes back in, I would like to introduce him and also John Hart, who is our Director of Research, is in the area and we will make sure that both of them get introduced, though they seem to have stepped out for the moment.

I would also like to recognize the tremendous support we have gotten from the Woodrow Wilson Center, both from Ron Morse and from Ernie Porta, who played a major role in organizing today's events.

The program for the day's seminar is in three parts, beginning with the focus on Korean economic strategy—business, government, and international trade.

The panel is assembled here, and this morning's moderator will be Ray Ahearn, immediately to my right. Ray will introduce the panelists. I am delighted that Ray has recently joined the Foreign Affairs and National Defense Division as an analyst who will focus on issues in Asian economic relations and particularly trade issues.

Ray has a strong background that brings together both economic expertise and sophistication in diplomatic issues and is experienced in Asian matters and has traveled in Asia and is very well-suited to take the lead in this morning's session.

After lunch we will shift to the social, political, and strategic context of the Korean economy and begin looking at some of the political and social context within which issues in United States-Korean trade arise.

The moderator for that session will be Larry Niksch, who is here on my right. Larry has been the major coordinator and organizer of this program for the Congressional Research Service.

He has had long experiences, I am sure all of you know, as an Asian analyst at the Congressional Research Service and certainly sees, both geographically and substantively, a tremendous scope, the character of the United States-Korean relationship, and certainly a perspective on congressional approaches to these issues. Larry will moderate the second session.

The third session, we will turn to the issues of American options with Korea and will be moderated by Bill Cooper, who is here in the front. Bill is an analyst in the Economics Division who also has a strong background in both economics and Asian issues and will be well-positioned to moderate that panel.

Bill Robinson, the Deputy Director, has just walked in. I want to recognize his presence.

I am delighted to have you all here. Let me just say a word about the terms of the program. The discussion will be not for attribution until after the proceedings are published in a committee print by the Committee on Ways and Means.

We will ask that in making comments from the floor, you identify yourselves so people have a better sense of who is here and what perspectives are reflected.

But you will not be identified by name in any proceedings in any written report of the seminar. So you need not worry about being identified in the comments or questions you may ask.

The panelists will, of course, have their remarks associated with them in the transcript that appears in the committee print.

With that, I, again, welcome you on behalf of CRS and the Woodrow Wilson Center and turn the proceedings over to Ray Ahearn.

Thank you very much.

## PANEL 1.—KOREA'S ECONOMIC STRATEGY: BUSINESS, GOVERNMENT AND INTERNATIONAL TRADE

PANELISTS:

In-June Kim, Visiting Scholar, Department of Economics, Dartmouth College; Advisor, Korean Ministry of Finance.

Peter Petri, Associate Professor of Economics, Director, Lindberg Program in International Economics and Finance, Brandeis University.

Eul Y. Park, Adjunct Professor of Asian Economy, Georgetown University; Consultant, World Bank.

Duk-Choong Kim, Professor of Economics and Director of Research Institute for Economics and Business, Sogang University, Seoul.

MODERATOR: Raymond J. Ahearn, Specialist in International Trade and Finance, Congressional Research Service, Library of Congress.

COMMENTATOR: John T. Bennett, President, Korea Economic Institute.

Mr. AHEARN. Thank you, Stan.

Our first panel, as you know, is focused on Korea's economic strategy. If there is one thing we all know about that strategy is that it has been very successful.

It has lifted Korea's standard of living in the past 20 years in terms of per capita income from a few hundred dollars to approximately $2,500 today.

We also know that Korea's economic strategy has been highly dependent on exporting. I think the first made-in-Korea product I became aware of was a baseball glove. It was a Don Budden special.

Now most of you probably do not know who Don Budden was, but he was a highly infamous shortstop for the Boston Red Sox. He had the record for making the most errors in one season. It is certainly no reflection upon the mitt, because I used it for at least 5 years.

We also know the story that Korea has gone from production of basically labor-intensive products into higher capital-intensive and more sophisticated technology areas. It has carved out market suc-

cess in products such as steel, VCR's, automobiles, TV's, computers, and the like.

What we do not know, I suppose, is how government business and labor have interacted in the Korean environment to produce this success. I hope our panelists will shed some light on this.

That might appear to be an academic question. But, of course, we would not be discussing purely academic questions in this setting.

With the success of the Korean exporting industries have come various problems. Korea's economic strategy is now the subject of considerable international criticism. If you read today's paper and you know the situation in Japan, I think there is a remarkable similarity.

Due largely to the rising trade surpluses that Korea is now accumulating, Korea is under increased pressure to restructure its economy and to become less dependent upon exporting for economic growth.

Korea is also under increased pressure to liberalize its control over imports, its control over financial investments, and its control over the exchange rate.

Now, I gather the view on the reaction from Korea is that much of this criticism is really just protectionism, pure and simple.

The view from Washington, however, is that it is an effort to bring a greater deal of reciprocity to bear on the overall economic relationship.

So the question remains, for the panelists to address, whether changes in Korea's economic strategy are justified—called for—and, if so, what is the scope for such an orientation to take place.

To shed light on these issues, we have an outstanding panel. As you can see, it is a gang of five. We have four panelists and what I would call a commentator who can be considered, in this context, the troublemaker.

Our first panelist is In-June Kim. He is a visiting scholar at the Department of Economics, Dartmouth College. He is an advisor to the Korean Ministry of Finance, and a consultant to ESCAP in Bangkok. He has a Ph.D. in economics from Harvard University, and he is published widely, as all our panelists have.

Peter Petri, to my right, is associate professor of economics and the director of the Lindberg program in international economics and finance at Brandeis University. He has written widely on trade theory and policy. His most recent book was "Modeling Japanese-American Trade," which was published by the Harvard University Press.

Our third panelist is Eul Park. Dr. Park currently is adjunct professor of Asian Economy at Georgetown University. He is a consultant to the World Bank. Before that, he was a senior fellow at the Korean Development Institute. He, too, received a Ph.D. from Harvard.

Our last panelist is Duk-Choong Kim. Dr. Kim currently is professor of economics and director of research for economics and business at Sogang University in Seoul. He has taught, also, at the University of Wisconsin and in Europe. Dr. Kim came all the way from Korea to be with us and share his ideas, and we do appreciate that.

So the format will be the four panelists will each have approximately 15 minutes to discuss these issues and then I will turn the floor over to John Bennett, who is our moderator.

As many of you know, Dr. Bennett is president of the Korean Economic Institute in Washington, and previous to that he had a distinguished career in the Foreign Service.

So we can proceed now with our first speaker.

Dr. Kim.

## STATEMENT OF IN-JUNE KIM, PROFESSOR OF INTERNATIONAL ECONOMICS, SEOUL NATIONAL UNIVERSITY

Dr. IN-JUNE KIM. It is my great pleasure to speak for this conference. Since I was asked to review the macroeconomic developments and trade policies of Korea, I will start with macroeconomic policies of the last decade.

### MACROECONOMIC POLICIES OF THE LAST DECADE

Two macroeconomic policies characterized the late 1970's: expansionary demand management and an overvalued Korean won.

After the first oil shock, thanks to the global economic recovery and the Middle East construction boom, Korea began to show a remarkable economic growth.

Under the favorable external environments, the Korean government continued to pursue expansionary demand management policies. The expansionary demand management policies are mainly attributable to two factors: the myth of forced inflationary savings and the government's direct intervention in changing industrial structures to heavy and chemical industries.

In the face of structural change in labor markets, forced inflationary savings through expansionary monetary policies no longer worked. In the mid-1970's, labor surplus in Korea disappeared, and the Korean economy moved from the so-called Lewis type world to the Keynesian type world.

Therefore, inflationary expectation began to be reflected wholly in wage contracts and the rate of wage increase exceeded inflation rates in the late 1970's. Under this circumstance, increase in the growth rate of the money supply only raised the rate of inflation and, in turn, the rate of wage increase. It did not promote capital formation as anticipated.

Industrial restructuring under government initiation was the major reason to adopt expansionary demand management policies. The rapid shift to heavy and chemical industries, however, was ill-planned and led to overinvestment and overlapping investment in those sectors.

Expansionary demand management policies overheated the economy and prolonged high rates of inflation in the late 1970's. The expansionary demand policies, moreover, worsened the subsequent downturn of the Korean economy.

Due to the expansionary demand management policies and cost push impacts of wage rate increase, the annual inflation rate of Korea exceeded that of the United States by more than 10 percent in the late 1970's.

Remarkably, the exchange rate of Korea remained unchanged during the period of 1974 to 1979. It means that the Korean won was overvalued in late 1970's. Export incentives schemes, the Middle East construction boom, and appreciation of the Japanese yen partially compensated for overvaluation of the Korean won.

In the face of second oil shock, however, Korea had to devalue its currency by a significant amount to restore price competitiveness.

The second oil shock in 1979 had more adverse effects on the Korean economy than the first one, because the second oil price rise was further aggravated by the expansionary demand management policies implemented previously.

In 1980, for the first time after twenty years of successful economic growth, Korea recorded a negative growth rate of 6.2 percent.

The second oil shock, the lagged adverse effects of expansionary demand management policies, an unprecedented bad harvest of 1980, and social unrest after President Park's assassination all contributed to the negative growth.

Even though the Korean won was devalued by 36.4 percent in 1980, Korea's balance of payments deteriorated rapidly and Korea further accumulated $14 billion in foreign debt during the period 1979–1981.

In the early 1980's, an emerging consensus targeted stabilization of the economy as a precondition for resuming economic growth. From the latter half of 1981, the government decided to couple incomes policies with restrictive demand management policies. Government demanded workers to sacrifice wage increases despite the high rate of inflation. The government argued that reduction in wage inflation would lead to a reduction in the inflation rate, and therefore there would be no significant reduction in real wage. The government set up a wage guideline and also made an effort to curb inflationary expectation being reflected on wage negotiation. Due to the success of the incomes policies and decline in import prices of raw materials, the rate of increase in GNP deflator fell to single-digit levels in 1982. The weak labor union and high rates of wage increase in the late 1970's contributed to the success of incomes policies. Incomes policies, however, will not be effective if repeated.

To restore price competitiveness, the Korean won was further devalued by 25 percent by the end of 1984. Because of the decline in prices of oil and raw materials, devaluation did not have a large inflationary impact on the domestic economy.

Thanks to the favorable external environments, Korea enjoyed the current account surplus, more than 10 percent economic growth and price stability in 1986. The declines in the price of oil and interest rates help Korea by reducing its oil import bill and debt service payments. These two developments also help Korea maintain price stability by reducing production cost. The appreciation of the yen also enhances Korea's export prospects, especially in large markets in which Korea competes with Japan.

## TRADE POLICIES OF KOREA OVER THE LAST DECADE

Trade policies of the 1970's can be characterized as heavy exports incentives coupled with restrictive import measures.

Exports incentives in the 1970's can be divided into three groups: tax policies, financial measures, and other export incentives. Tax policies cover both domestic tax measures and tariff measures. It is true that tax and tariff incentives give a more favorable treatment to exports vis-a-vis goods produced mainly for domestic use. Imported intermediate goods and capital goods for exports production were exempted from the tariff. Exports were also exempted from indirect taxes. After the introduction of value-added tax in 1977, exports continued to be exempted from the tax. Most tax incentive measures, however, should not be regarded as genuine export subsidies. Exemption of exports from indirect taxes and tariff exemption of intermediate imports for exports merely allow exporters to operate under a free trade regime. Other countries provide the same kind of incentives to help maintain price competitiveness.

Financial incentives played a major role in export promotion in Korea. Financial incentives for export promotion took two different forms: the preferential allocation of financial resources, and the interest rate subsidy. Throughout the 1970's export credit was provided at a preferentially low rate vis-a-vis other bank credit. Thus, exporters received a direct interest rate subsidy. The major financial inventive to exporters, however, was the preferential allocation of financial resources. Throughout the 1970's, substantial gaps between the interest rates of bank credit and curb market loans persisted. Most official loans were allocated by credit rationing at negative real interest rates. Therefore, the preferential credit allocation was the more important form of subsidy; the implicit value of which far exceeded that of the direct interest rate subsidy, even though such effects are very hard to quantify.

Besides the export incentives mentioned above, there were also other informal incentives. Export-import linkage systems, attention of the highest authorities to exporters' problems, and the more rapid expedition of paperwork can be listed as informal incentives in the 1970's.

While seeking to increase exports, Korea continued to restrict imports. Imports were primarily controlled by two policy instruments: quantitative controls and tariffs.

Korea did not loosen quantitative controls on imports during the 1970's. When the negative-list system was first adopted in 1967, the ratio of import liberalization by items was 60.4 percent. The ratio steadily declined to 49.1 percent in 1975 and then returned to 60.7 percent in 1978. Quantitative controls were tightened to protect newly established heavy and chemical industries.

The tariff system was reformed twice in the late 1970's but without substantial reduction in tariff rates. The tariff reform of 1976 attempted to make the tariff structure comply more with the drive toward heavy and chemical industrialization. To protect the newly established industries, tariffs on heavy and chemical industry products were raised while tariffs on already over-protected industrial products were reduced. The reform had the effect of making tariffs more uniform, but the average tariff rate declined only from 31

percent to 30 percent. The 1978 tariff reform resulted in the reduction of the number of very high tariff items and the average rate dropped to 25 percent. The efforts for the liberalization of imports in 1978 had to be abandoned because of rapid deterioration in the balance of payments.

After the successful stabilization of the economy in early 1980's, policies toward a free trade regime were seriously undertaken. It was believed that extensive imports restrictions on intermediate and capital goods had an adverse impact on productive efficiency, forcing domestic producers to use low-quality, high-cost domestic goods. There were also ever-mounting pressures from industrial countries to open up Korea's domestic market. Therefore, it was natural for Korea to move in the direction of a free trade regime.

Financial incentives on exports were greatly reduced. Direct interest subsidies were abolished in 1982, and financial subsidies in the form of preferential credit allocation declined due to the reduction in preferential margins on bank credit relative to curb market loans. The reduction can be attributed to the monetary policy reform and the success of price stabilization.

In regard to imports, a series of imports liberalization policies have been undertaken. The policies put a major emphasis on the elimination of quantitative restriction, a uniform tariff reduction and the elimination of sectoral differences in effective protection. In 1983, the Ministry of Trade and Industry announced an import liberalization program and the Ministry of Finance announced a tariff reform plan, both covering the five-year period up to 1988. According to the Ministry of Trade and Industry program, import liberalization ratio rose over 90 percent in 1986 and will rise over 95 percent by 1988. The tariff reform which the Ministry of Finance undertook in 1984 will cut off tariffs on individual products by about one-third over a five-year period. The reform also introduced an adjustment tariff to facilitate elimination of quantitative restrictions. The reform clearly suggests that Korea is prepared to move in the direction of trade liberalization.

To resolve the trade conflicts between the United States and Korea, the Korean government agreed to eliminate prohibitions against foreign firms underwriting life and fire insurance and to offer greater protection to U.S. intellectual property rights.

### STABILIZATION AND LIBERALIZATION OF THE KOREAN ECONOMY

In view of Korean economic development, stabilization of the economy was the precondition for liberalization of the economy, and Korea should have taken stabilization policies in the late 1970's.

If Korea had adopted stabilization policies in the late 1970's, the Korean economy would have grown without accumulating a large amount of foreign debt. If price competitiveness had been restored by maintaining the inflation rate at the level of major trading partners, Korea could have enjoyed either balance of payments equilibrium or surplus in the late 1970's due to the favorable world economic environments. Also, the adverse impacts of the second oil shock on the balance of payments could have been minimized with stabilization policies in the late 1970's. If, through the success of

stabilization policies, Korea had accumulated less foreign debt, the snowballing effects of extremely high interest rates on foreign debts in the early 1980's could have been avoided.

By implementing stabilization policies in the late 1970's, Korea could have minimized the stagflation of the second oil shock. The economic downturn would have been less severe, and the inflationary shock of exchange rate devaluation could have been avoided. Since Korea is a small, open economy, nothing can be done about external shocks except making the domestic economy less vulnerable to the shocks.

Through stabilization policies in the late 1970's, Korea could have reduced the direct costs of prolonged high rates of inflation. The continued high rate of inflation began to bring about a rapid rise in speculative transactions, uncertainty and inefficiency in the late 1970's. It also discouraged the improvement of productivity and technology development, and made it more difficult to fully exploit the growth potential of the Korean economy.

Stabilization policies in the late 1970's would also have enabled Korea to pursue liberalization policies earlier and benefit from those policies earlier. Expansionary demand management policies, however, prevented the adoption of liberalization policies.

Since annual inflation rates of Korea exceeded those of major trading partners by more than 10 percent and the exchange rate remained fixed during the period 1974-79, the Korean won was overvalued. Therefore, export incentives systems and imports restrictions could not be lifted. Those measures were actually enhanced to compensate for the decline in price competitiveness caused by the higher rate of domestic inflation. With stabilization of the economy, distortions in trade sectors could have been removed and trade liberalization could have been initiated earlier, maintaining stable exchange rates.

Export incentives through financial measures generated distortion in financial sectors. Also, with more than 20 percent annual inflation rate, there was a substantial interest gap between organized and non-organized financial sectors, and real interest rates of bank loans were negative in the late 1970's. Because of the higher domestic inflation rate and fixed exchange rate during the period 1974-79, interest rates on foreign loans in dollar terms differed from those on domestic loans by the inflation gap between Korea and the United States, which also led to a distorted allocation of financial resources. With stabilization of the economy, the magnitude of distortion would have been much smaller and the government could have initiated liberalization of financial sectors earlier. There is no doubt that stabilization of an economy is a precondition for liberalization of the economy.

After successful stabilization of the economy in the early 1980's, liberalization of the economy was seriously undertaken both in trade and financial sectors.

In order to liberalize the financial sectors, the Korean government raised real interest rates, eliminated interest rate subsidies for preferential loans and reduced the interest gap between the organized and unorganized sectors of the financial market. Because of success in stabilization policies, those liberalization policies affecting financial sectors began to bear fruit. But problems of insol-

vent enterprises in major industries, such as overseas construction, shipbuilding, and marine transportation, will still be a major constraint on liberalization of the financial sectors.

For Korea to leap to an advanced economic stage, financial liberalization should be pursued simultaneously with trade liberalization. However, before opening up domestic financial sectors to foreign competition and allowing capital account liberalization, the domestic financial sector must be sufficiently strong and the capital market should develop sufficiently to allow the benefits of capital account liberalization to be reaped. Many studies on Latin American liberalization experiences have shown that developing countries have little to gain from capital account liberalization. Because of capital outflow, improvements in balance of payments do not seem to ease the debt management problems of Latin American countries. Capital market liberalization has also disrupted macroeconomic policies to such an extent that it frustrated trade and financial market liberalization in those countries. Korea should not make the same mistake that Latin American countries have.

## PAST LESSONS, CURRENT CHALLENGES

In the past, when Korea faced external shocks after the prolonged expansionary demand management policies, it suffered real hardships. The prolonged expansionary demand management policies not only disrupted the process of economic liberalization, but also aggravated the negative effects of external shocks. Subsequent extremely restrictive demand management policies led the Korean economy into recession. During the remainder of the 1980's, therefore, Korea should not forget these past lessons and should not repeat the same kind of mistakes. Korea should continue pursuing stable demand management policies.

Some people, however, worry about the possibilities of economic developments in the late 1980's similar to those in the late 1970's.

After the first oil shock, the Korean economy enjoyed favorable external factors: recovery of the world economy, the Middle East boom, and appreciation of the Japanese yen. Beginning with the second oil shock, however, the Korean economy suffered from unfavorable external economic developments. Since 1986, as before the second oil shock, the Korean economy has greatly benefited from the so-called three lows: depreciation of the dollar, a sharp drop in oil prices, and decline in interest rates. Korea, however, cannot expect those favorable external factors to last for a long time. There might be another upsurge in oil prices, increases in interest rates, and recession of the American economy after five consecutive years of economic recovery. Also there is a fear that a protective tendency against Korean exports will be intensified among industrialized countries.

In the late 1970's, the government took expansionary demand management policies to restructure the economy toward heavy and chemical industries with one stroke. It is believed that those policies were politically motivated to justify the authoritarian rule of the late President Park. Since national elections and the Summer Olympics are scheduled in 1988, there might be non-economic fac-

tors which lead to expansionary demand management policies in the late 1980's.

In the late 1970's, Korea went through political turmoil after the assassination of President Park. In the process of power transfer, there might be a possibility of political unrest in the late 1980's.

Fortunately, the possibility that the late 1980's will witness the same economic and political developments as in the late 1970's is relatively small. In sharp contrast to double-digit inflation rates in the 1970's, Korea has succeeded in stabilizing its economy in the mid-1980's. Also it is believed that President Chun will step down in February 1988 as scheduled. Korea, however, should not forget past lessons. Korea should be very careful not to overheat the economy while external factors are favorable. Such caution will undoubtedly prevent disruption of the liberalization programs and aggravation of the subsequent economic downturn, whether they are caused by internal or external factors.

There is no doubt that liberalization is necessary for Korea to leap to an advanced stage of economy. The process of trade liberalization should be continued to promote efficiency in the domestic market as well as to reduce the trade conflicts with industrial countries. One of Korea's major challenges over the next decade will be to maintain the overall balance-of-payments equilibrium while correcting bilateral trade imbalances.

Because of the trade account surplus vis-a-vis the United States in recent years, Korea is often mentioned as the second Japan. This is, however, an unfair accusation. Until last year, Korea had suffered from chronic balance-of-payments problems and its foreign debt outstanding reached $46 billion at the end of 1985. Only last year did Korea enjoy an overall balance-of-payments surplus for the first time in its entire economic history. Korea has never accumulated foreign assets and has no intention of doing so.

Because of the bilateral trade deficits, the American government put pressure on the Korean government to revalue the Korean currency and open up financial sectors.

The exchange rate should be determined at the level which maintains an overall long-run equilibrium. There is no strong indication that the current exchange rate deviates by a significant amount from the long-run equilibrium exchange rate, even though further study on the optimal exchange rate is necessary. Wide fluctuations of exchange rates between industrial countries caused by capital flow, however, make it more complicated for Korea to decide the optimal exchange rates. It is not desirable to reflect on Korea's exchange rates every time the exchange rates between industrial countries fluctuate as a result of capital flow. It will undoubtedly undermine the stability of the Korean economy because the share of the open sector (that is, exports plus imports) accounts for more than 80 percent of Korean GNP.

Korea is very cautious about opening its financial sectors to foreign competition for several reasons. First, Korean financial sectors cannot compete with foreigners on an equal basis due to the accumulated past distortions and infant stage of financial sectors. Second, there is a fear that foreign dominance of the financial sectors will undermine the effectiveness of stabilization policies. Third, opening the financial sectors is directly related to the issue

of capital account liberalization. At this stage of economic development, capital account liberalization will do more harm than good to the Korean economy. Finally, opening the financial sectors will not contribute much to improving the bilateral trade imbalance between the United States and Korea. There is a strong chance that the third party will enjoy the fruits of opening Korea's financial sector.

Appreciation of the Japanese yen and the trade liberalization policy of Korea will eventually correct the bilateral imbalance. In the meantime, efforts to diversify Korean import sources will directly contribute to solving the bilateral trade imbalance between the United States and Korea. Korea should make great efforts to maintain an overall current account balance as well as bilateral current account balance with important trade partners.

Thank you.

Mr. AHEARN. Thank you, Dr. Kim, for that concise analysis of Korea's macroeconomic policies. I am sure we will be coming back to your points on capital account liberalization later.

Dr. Petri.

## STATEMENT OF PETER A. PETRI, ASSOCIATE PROFESSOR OF ECONOMICS, BRANDEIS UNIVERSITY

Mr. PETRI. When Ron Morse previewed our discussions a few minutes ago, he mentioned that we would have Koreans speaking about Korea and Americans speaking about the United States, so I thought I'd be a little mischievous and speak about a country that I've heard mentioned three times already today, and that is Japan—and, more specifically, about the similarities and contrasts between Korea and Japan.

I have been interested in both countries for some time and I have thought quite a bit about what similarities and contrasts there may be between these countries, and I'd like to share with you some of these thoughts. They are still taking shape, and to some extent I am offering these thoughts as a way to stimulate discussion rather than as established scientific facts. I should say that my written comments include more than what I will say in my spoken comments about Korean policies and strategies and how they have evolved over time, and I will, in my comments, focus only on this one issue of contrast.

As I have been thinking about these two countries together, it occurs to me that thinking about them is a bit like trying to peel an onion: there are many layers to the comparison between Japan and Korea, and similarities on one layer become contrasts on the next layer. My comments, will have a little of that "onion" effect because that's where things are in my mind.

On the first layer, there are very strong similarities which come out frequently in political discussion. Both countries run large bilateral trade surpluses with the United States. Indeed, Korea's, as a proportion of its GNP, is larger than Japan's by a good margin. Both countries now have overall trade surpluses, although this is a rather new development for Korea; it's something that has been true for quite some time for Japan.

Both countries have had activist governments, and, indeed, Korea's government until the 1980's has been, I would argue, more interventionist in promoting industrial development than the Japanese government.

And, finally, both countries have had very rapid growth, high rates of saving, and enormous success in opening world export markets.

So that, on the first layer, there seem to be a lot of things that these two countries have in common. And so Americans begin to wonder how many years it will take before the United States will have to fire a shot across Korea's bow like the semiconductor tariffs that shook world capital markets yesterday.

But then, at the second layer, one sees more contrasts, and some of the similarities that seemed so strong in the first layer of the onion are not there any more. Korea is much smaller than Japan. Given the increased value of the yen in terms of dollars, if one translates both countries' GNP's into dollars, Korea's GNP is no more than 5 or 6 percent that of Japan. Of course, Korea is much poorer—you have to look at the exchange rate each day to be able to fix this fraction—but no more than one-sixth or one-seventh that of Japan's GNP per capita.

And then, Korea is a far more open economy. If one measures openness in terms of imports or exports relative to GNP, Korea is approximately three times as open as the Japanese economy. And, indeed, openness has played a very important role in the Korean strategy. One of the great innovations of Korean industrial policy has been to make foreign goods accessible cheaply to domestic producers engaged in export industries. That was not the case for all foreign goods, but certainly export producers have had wide-ranging access, automatic access, to foreign products, so much so that in the late 1970's estimates suggest that as much as two-thirds of official tariffs were in fact not collected because exporters were importing the goods free which otherwise would have come under tariffs.

And, of course, there is the issue of debt. Korea is quite deeply indebted, and, like Brazil or any other debtor country, Korea has to run a trade surplus in order to pay for the servicing costs of that debt, and perhaps to retire that debt if it is in its national interest to do so. The difference, of course, is that Korea has managed to do that now while some of the major Latin American debtors whom we would like to see in that position are not getting there very fast.

And then, finally, there is a range of contrasts, in the temperament of Korean business, in the relationships between business and government, as between Korea and Japan—but I'm getting out of my depth here, I'd better leave this to the panel on society that comes on after economics.

That's the second layer of the onion. Let me go to the third layer. I have recently written a paper on Korea's export niche and how it's changing over time, and in this paper it gradually became clear to me that one could think of an "economics of following" in which one country adopts the model of another country. It could make sense to pattern one's own economic activities in ways that are similar to that of a model country in order to take advantage of very natural economic benefits, advantages of technologies and

markets having been developed by somebody else, perhaps over a long time and at great cost.

This kind of following relationship does in fact characterize Korea's export niche vis-a-vis the Japanese export niche. And, indeed, this is evident in the data. Korea's export pattern is more like Japan's export pattern than the export patterns of a lot of other east Asian countries whose income levels are closer to Japan's than Korea's is. In regression equations which explain Korea's export pattern, a variable which reflects Japanese export patterns fifteen years ago is an extremely significant variable, more significant than other variables that are reasonably included.

So that if one looks carefully at the pattern of Korea's export structure and industry structure, there does seem to be a strong empirical similarity between it and Japan.

Now, there are various reasons for this similarity. Technological imitation is, of course, a very important one. Early development of major export industries—and I think the best examples are steel and automobiles—have involved strong close cooperation with Japanese firms. The Japanese firms, in the case of steel, got so worried that they've stopped further cooperation after the first stage of the development of the Korean steel industry, but nevertheless at critical stages one sees strong, close technical cooperation.

The bulk of technology joint ventures that Korea has with other countries involves Japan, although one might expect that in the future increasingly American companies will be involved as well. The bulk of capital goods, which incorporate technology, comes from Japan. And then there are stories which I just don't know how to evaluate in terms of their quantitative significance, of Japanese engineers flying to Seoul on weekends, presumably to transfer technology, although that's not the official description. I don't know how frequently this occurs; but it symbolizes, I think, a recognition on the part of Korea, much like Japan recognized many years earlier, that often the best way to make dramatic head way in productivity and technology is to look at what exists and make intelligent and thoughtful adaptations of it to local economic environment.

Another area that is very important is imitating marketing strategies. Here, for example, it struck me as interesting that when Hyundai launched automobiles in North America, it hired the people who ran Toyota's marketing efforts. First they did that in Canada, with people who ran Toyota's marketing efforts in Canada; then they did that in the United States, with people who ran Toyota's marketing efforts in the United States.

This all is very sensible, very natural, but it shows that experience which is gathered by one country in the process of opening markets in fact becomes useful and valuable to another country later on, which is trying to open markets as well.

In some cases, the similarity of Korea and Japan has been actually promoted by American protection. You undoubtedly know of color television sets where protection against Japan opened up markets to Korea; steel, quite similar; automobiles, in the case of Canada—there were restrictions on Japanese exports to Canada which helped Hyundai launch its automobile in Canada. In the United States there were voluntary export restraints which, as we

know, have pushed Japanese models in the upper cost ranges of the auto market, so there, too, a low-price niche opened up through American protection against Japan. This pulled Koreans into patterns which the Japanese had followed earlier, and offered new business opportunities in the low-priced auto market.

That's my third layer: a series of very interesting similarities quite easily explained in terms of good economics, good economic strategy.

Now, on the fourth layer—and this is as deep as I'll go; I think there are probably more layers, but I will stop at the fourth layer—I see contrasts again. I see a much greater willingness on the part of Koreans, both government and the private sector, to integrate with the world economy, that is, to form joint ventures, partnerships, with the world economy, and particularly with American firms, to form competitive combinations that might have an effective position against Japan in world markets. The government, I think, has been quite receptive to the problems that other governments, and the United States government in particular, have raised. It has pursued liberalization—we have already heard about that from Professor Kim—in the areas of the financial sector as well as in the areas of imports. I think two other programs that I would mention would be the import diversification, and import localization programs of Korea, which are aimed in the first case, at shifting imports from Japan to the United States; and in the case of the localization program, at shifting from imports from Japan to domestic production in Korea. These policies don't please me as an economist who prefers market solutions to government-engineered solutions. Nevertheless, they indicate that the Korean Government is extremely conscious of its problems in the United States and is willing to risk a significant amount of confrontation with Japan in order to avoid confrontation in the United States.

Now, I worry about this a little bit, because in the perspective of what is likely to happen to the world economy in the next few years, my guess is that American imports have to shrink, while Japanese imports have to grow. The rates of growth of these two markets will be quite different in the future than they were during the last five years. And I worry about Korea putting its eggs in the American basket. But that's a different story.

There's not been much cooperation with the United States, however, on this issue of exchange rates, Professor Kim has already given a very broad and very useful context, but I just want to quickly highlight two points. One is that I find, when I visit Korea, the issue of the psychology of foreign debt to be very important—I think more important than one might expect. There are people in all walks of life who worry about what Korea's debt is relative to GNP. You don't find that in many other debtor countries. Therefore the government has had as an important element of its strategy to retire as much of that debt as it can, even before the very fortuitous circumstances of the last year or two when the yen has appreciated so sharply against the dollar there was a plan in effect to retire debt when it looked like this would entail more cost in terms of foregone growth. I remember meetings a couple of years ago in which economists, mostly foreign economists, were criticizing Korean plans for being not ambitious enough in the sense of

not counting enough on borrowing from the world markets in order to take advantage of very high return investments at home.

So now, when they have an opportunity to retire the debt, it's clear that that is the first thing that the government is going to do with its windfall.

The second point that I would like to make is that trying to stimulate the economy in order to reduce the trade surplus or current account surplus, in the context of 12-percent growth is a tough macroeconomic problem. It is not the problem that Japan has where growth is extremely sluggish compared to past Japanese growth. And, of course, it's in some ways the opposite of the difficult problem that England has struggled with for most of the postwar period where it had a trade deficit coupled with sluggish growth. The combinations, trade deficit and sluggish growth, or trade surplus with very rapid growth, present macroeconomic dilemmas that are not easily solved.

My guess is that in the end there will have to be more change in the value of the won relative to the dollar, but that one can expect to see that change come about more gradually than we would like in the United States.

I should say also that the private sector has been quite receptive to internationalization. Korean companies have turned to foreign investment more rapidly—as Hyundai has demonstrated in Canada, than in Japan. There have been strong foreign linkages, such as between other auto producers and American companies in order to assure access to the American market. There have been buying missions and the like. So I think there is a real receptivity on the part of the private sector, too, to try to preserve good relations with the United States.

That's the last layer, and I'd like to pull back a minute and ask where this leaves us with respect to United States-Korean trade relations in the future.

First of all, all of this suggests that we have the basis for a confrontational setting but a less confrontational relationship than has been the case over the last few years with Japan. I say this partly because of the receptiveness of both government and private sector toward international cooperation, and partly because I think that many of the markets that Korea threatens are markets not so much held by American companies.

The second point that I would like to stress is that nevertheless this set of products and this set of issues is likely to lead to managed trade, and there will be a lot of trade between Korea and the United States that will be negotiated. I've done some calculations looking at Korean trade patterns and the incidence of protection across different commodities in developed countries, and it turns out that Korea tends to be exporting precisely those products where generally protection is intense, both in terms of nontariff barriers and in terms of tariff levels. In fact, I had divided the world up into seven parts, with Korea being one of those seven, and Korea showed a much higher propensity to export protection-prone products than any other region, including other east Asian regions.

So I think there will be trade management.

To this end, I would like to conclude my paper with three principles that I think should guide American policy in this managed context of trade.

The first principle, is that Korea ought to be treated fairly and sympathetically as an independent country, not just as a country next to Japan physically, in the alphabet, and in American minds. Korea has set an excellent example of how hard work and intelligent economic strategy lead to development—a very important message for the United States to support.

The second in the list of principles that should guide managed trade in the future is that Korea should be permitted to compete against Japan. This seems like a rather unusual point, but in fact I think we do want to avoid situations in which voluntary restraints in fields such as semiconductors or automobiles, and a lot of other areas, essentially carve up the market so that nobody competes against anybody and prices are high to American consumers. I don't think that serves the economic interests of the United States.

And the third is—that's the converse of that—is that other countries ought to be permitted to compete against Korea. By this I mean the set of managed trade issues in the areas of textiles, clothing, and, more generally, under the Multi-Fiber Agreement, which do protect Korean shares against other competitors, such as the Philippines, and without which we would have seen much smaller Korean shares today if free-market forces were at work.

Thank you.

Mr. AHERN. Thank you. Your prepared statement will be inserted in the record.

[The prepared statement follows:]

PREPARED STATEMENT OF PETER A. PETRI, ASSOCIATE PROFESSOR OF ECONOMICS, BRANDEIS UNIVERSITY

JAPAN, KOREA, AND UNITED STATES-KOREAN TRADE RELATIONS

*Korea's Emerging Image*

In recent months, South Korea has caught the attention of the American economic policy community. The context is the troubling U.S. trade deficit, to which Korea contributed $7 billion last year, as well as Korea's first overall trade surplus in its postwar history. Attention to South Korea is long overdue. Since 1960, its per capita income has risen four-fold, and its exports moved from ranking as the world's 101st largest in 1960 to the 13th position in 1985. Korea's achievements and policies are widely admired in developing countries, many of which are trying to replicate its development "miracle."

To American observers, however, Korea is less a development success story than a competitive threat—potentially "another Japan." Although the sizes of the two countries are dramatically different (see Table 1), there are indeed similarities between their development experiences. Korean and Japanese economic endowments are comparable: no natural resources to speak of, very limited agricultural potential, abundant high quality labor, and rapidly growing capital stock due to high savings. In both countries, the imitation and adaptation of foreign technology have played vital catalytical roles. In the earlier stages of development both governments used activist policies to accelerate industrialization and manufacturing is now a leading sector in both Korea and Japan. In addition, because of their fast pace of development relative to the rest of the world, both countries have rapidly upgraded the sophistication of their manufactures, and frequently target new product for the American market.

TABLE 1.—SOME CONTRASTS BETWEEN KOREA AND JAPAN, 1985

| Indicator | Korea | Japan | Korea/Japan (percent) |
|---|---|---|---|
| Basic Indicators: | | | |
| GNP, US$ billions | 83.1 | 1,220.1 | 7 |
| Population, millions | 41.6 | 120.8 | 34 |
| GNP per capita, US$ | 1,998 | 10,100 | 20 |
| Investment/GDP, percent | 29 | 28 | 104 |
| Saving/GDP, percent | 28 | 31 | 90 |
| External indicators: | | | |
| Exports, US$ billions | 26.4 | 173.9 | 15 |
| Imports, US$ billions | 26.5 | 117.9 | 22 |
| Current Account, US$ billions | −0.9 | 49.3 | −2 |
| Net Foreign Assets: Cumulated Current Account, 1960–1985, US$ billions | −29.5 | 140.3 | −21 |
| Exports/GDP, percent | 31.8 | 14.3 | 223 |
| Imports/GSP, percent | 31.9 | 9.7 | 330 |
| Cumulated Current Account/GNP, percent | −35.5 | 11.5 | −309 |
| Economic structure and living standards: | | | |
| Agriculture/GDP, percent | 14 | 3 | 467 |
| Industry/GDP, percent | 41 | 40 | 103 |
| Defense Spending/GDP, percent | 6 | 1 | 600 |
| Life Expectancy, years | 68 | 77 | 88 |
| Infant Motality, per 1000 | 28 | 6 | 467 |
| Secondary School Enrollment, percent | 89 | 94 | 95 |
| Higher Education Enrollment, percent | 24 | 30 | 80 |

Sources: World Bank (1987), International Financial Statistics (1986), World Development Report (1986).

But the differences between Korea and Japan may be more important than the similarities. In particular:

Korea is small and poor compared to Japan; its standard of living is like that of Japan's in the 1920s. Korea's GNP is 7 percent of Japan's—about that of the state of Missouri.

The Korean economy is nearly three times as open to world trade as Japan's: exports and imports each amount to approximately 32 percent of GNP, as compared to approximately 14 and 10 percent, respectively, for Japan. Korean policies have encouraged a high degree of internationalization by letting imports in relatively freely if they are to be used in the country's large export sector.

Korea is deeply in debt: its overall current account has been in deficit throughout the postwar period, and foreign obligations now amount to approximately 35 percent of GNP. Japan, of course, has generally run current account surpluses in the past fifteen years and has accumulated foreign assets in the neighborhood of 12 percent of GNP.

Korea imports more manufactures than raw materials; indeed, Korea now runs a $6 billion trade deficit with Japan where many of the components and capital goods required for Korean manufactures are made.

These differences have important implications for Korean strategy. Because of the economy's smaller size and earlier stage of development, exporting and importing are much more important than in Japan. Even with continued rapid growth, the Korean economy will remain too small and its resources too limited to permit self-sufficient development—much as Missouri is too small to isolate itself from the rest of the United States. For better or worse, Korea has to rely on a vigorous and open world economy to continue its fast growth, and will undoubtedly tailor its policies to achieve this end.

*Is Korea Following Japan?*

Differences in income, size, and overall trade positions notwithstanding, there are considerable similarities between Korean and Japanese export patterns, particularly if current Korean patterns are correlated with Japanese exports fifteen years ago. There is also anecdotal and empirical evidence to suggest that both Korean firms and the government are consciously trying to replicate Japanese strategies and policies.[1]

[1] See Peter A. Petri, "Korea's Evolving Export Niche," forthcoming in *World Development*.

There is nothing mysterious about these efforts. Japan, though well ahead of Korea in level of development, has created extraordinarily successful export industries with endowments roughly similar to Korea's. This provides ample opportunities for copying Japanese products, process technologies, and even marketing strategies. Korean firms have been very sophisticated in reverse engineering and have made excellent use of foreign capital goods.[2] They are also creative in using human capital: for example, they often fly in Japanese engineers on weekends to help transfer Japanese technology. And, when Hyundai launched its automobiles in Canada and the U.S., it was only natural that it hired individuals who had been involved in Toyota's marketing efforts.

There is a second type of benefit associated with following Japan. Through years of effort, Japan has established strong marketing channels and a good reputation for technology and product quality. These investments do not automatically carry over to new East Asian entrants, such as Korea, but they have undoubtedly made vendors and consumers more willing to experiment with new East Asian products. Furthermore, selective protection applied against Japan in such products as color televisions, steel, automobiles, and now semiconductors, has virtually handed over Japanese marketing investments to competitive exporters such as Korea.

But Korean export strategy has differed from Japan's in one crucial respect. Most Japanese exports were launched by industries with established domestic markets. In many cases, these markets had been developed under tight trade barriers. By contrast, Korea has often launched exports without significant protection or even production experience at home. This was certainly the case with the labor-intensive exports of the 1960s and 1970s. In the mid-1970s, Hyundai's massive shipyards were built simultaneously with their first major export ships. Even in automobiles, where Korea came closest to copying the Japanese model, the decisive move into exports in 1985 involved new factories and technologies specifically developed to serve foreign markets. This is not to say that infant industry protection is unknown in Korea; for example, imports of PCs were not permitted until competitive domestic expertise developed (it only took three years). But in general, subsidies and export incentives, rather than protection, seem to explain the bulk of Korea's achievements.

*Export Promotion and Korean Industrial Policy*

Government has played an active role in the Korean economy since the end of the Second World War. Before 1960, economic priorities were overshadowed by the Korean War and politics; the economy stagnated under excessive regulation and corruption. Between 1960 and 1973, the economy accelerated under strong export incentives. From 1973 until about 1979, the government provided selective support for heavy and chemical industries. Since 1979, policy has aimed to increase the role of markets, but has not shied away from "functional" support for manpower development and technology and occasional direct support for distressed industries.

Korean policy is best known for aggressive export promotion, although this approach was practiced in pure form only under the earliest of the three policy regimes. At its height in the mid 1960s, exports were promoted with: subsidies for inputs such as electricity, credit at interest rates below the already-low rates of state-owned banks, a novel letter of credit system that extended the incentives available to exporters to those who produced intermediate goods for the export industries, permission to import certain heavily-protected commodities beyond actual requirements, and protection in domestic markets. Exporters also received government honors, prizes, and varied bureaucratic privileges; the Blue House had an "export situation room" for keeping daily track of the export performance of the larger companies relative to preassigned targets.[3] The incentives for exporting were so great that Korean companies sometimes bought export orders from each other, at a premium, in order to meet export targets.

The extent of intervention practiced during this period is a far cry from the market-oriented strategies advocated by most development economists. Surprisingly, however, empirical analysis has shown that the particular combination of export incentives and import protection practiced by Korea in the 1960s and early 1970s pro-

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[2] See Larry Westphal, Linsu Kim, and Carl Dahlman, "Reflections on Korea's Acquisition of Technological Capability," World Bank Discussion Paper No. DRD77 (1984)

[3] The export promotion policies are described in detail in L. Jones and I. Sakong, *Government, Business, and Entrepreneurship in Economic Development: The Korean Case*, Cambridge: Harvard University Press, 1980, A. Krueger, *The Developmental Role of the Foreign Sector and Aid*, Cambridge: Harvard University Press, 1979, and Y. W. Rhee, B. Ross-Larsen and G. Pursell, *Korea's Competitive Edge: Managing Entry into World Markets*, Baltimore: Johns Hopkins University Press, 1984

duced a relatively industry-neutral incentive structure. Unlike in most other developing countries, profits created by protection in the home market were approximately offset by subsidies to exports. Thus, the decision whether to produce for the home market or export was ultimately based on economic criteria, and Korea developed well-chosen export industries in labor-intensive areas such as apparel and electronics assembly.

Around 1973 Korean economic policy became considerably more intrusive and ambitious. Strategic sectors were identified and targeted for rapid development in what eventually became known as the "heavy and chemical industry" (HCI) drive. This was the period when the Japanese model was most closely followed. The sectors promoted—including petrochemicals, metals, and heavy machinery—required large-scale, capital-intensive investments and enjoyed ready access to credit at below-market rates. Firms upstream from the promoted sectors were often required to use domestic intermediate goods in preference to imports, and some of the export incentives previously offered to traditional exporters were removed. The government's macroeconomic policy compounded the bias in favor of the promoted sectors by permitting the real value of the won to appreciate, further curtailing the profitability of traditional exports.

By the late 1970s Korea's export performance had sharply deteriorated and excess capacity emerged in the heavily promoted industries. Large trade deficits arose and led to increased international indebtedness. Some of these problems, to be sure, reflected worldwide economic developments. In any case, the Korean government responded with both macroeconomic and microeconomic solutions. Belt-tightening and devaluation helped to reduce the trade deficit and reestablish the competitiveness of traditional exports. More importantly for the long run, the "heavy and chemical industry" drive was halted, and steps were taken to remove sectoral bias from the allocation of credit.

Today's economic leadership generally regards the HCI drive as a mistake. In the dominant view, the government had overreached its capabilities by trying to "create" too many new sectors from scratch, and exposed the economy to grave risk by diverting resources to large, capital-intensive industries.[4] Some Korean planners contrast the approach with that of Taiwan, where a smaller-scale industrial sector is thought to be able to adjust better to changes in the international environment.

The opponents of this view emphasize that some of today's most successful industries, including steel and automobiles, got their start during the HCI push, and that the effort succeeded in launching industries that represent Korea's next phase of comparative advantage. They point out that this transition had to be government-led, since the capital market—mainly the banking system—was not independent or deep enough to shoulder the risks involved without government direction. Further, they argue that the excesses of the HCI push at least partly reflected non-economic goals, that is, the desire to develop the base for an armaments industry because of the possible withdrawal of American troops.[5]

*Curren. Policy Directions*

Wherever the truth may lie with respect to HCI policy, since 1979 the government has been disentangling itself from industrial decision-making.[6] It has:

Eliminated interest rate and input subsidies; increased bank lending rates, thus narrowing the differential between interest rates in the formal credit markets and the curb market; reduced the scope of specially targeted loan funds; privatized the commercial banks and permitted the development of a wide range of non-bank financial institutions; increased somewhat the permitted activities of foreign-owned banks; eliminated input subsidies; embarked on a pre-announced schedule of import liberalization; revised the tariff schedule in order to reduce the dispersion of tariff rates; liberalized somewhat the rules governing foreign investment; and replaced a series of sector-specific industry promotion laws with a single, more neutral law.

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[4] This point of view is frequently articulated, but there is no single article that presents it in writing. Elements of the argument can be found in S. Young, "Role of Trade Policy in Korea's Economic Development and Problems of Import Liberalization," Seoul: Korea Development Institute, 1985, mimeo.

[5] See for example, H. Pack and L. Westphal, "Industrial Strategy and Technological Change: Theory versus Reality," Swarthmore College, 1985, mimeo.

[6] Some of these changes are documented in U.S. International Trade Commission, Foreign Industrial Targeting and Its Effects on U.S. Industries: Phase III: Brazil, Canada, The Republic of Korea, Mexico, and Taiwain, Publication 1632, Washington: USITC, 1985. See also Y.J. Cho, "The Effects of Financial Liberalization on The Development of The Financial Market and the Allocation of Credit to Corporate Sectors: The Korean Case," World Bank Report DRD166, mimeo.

No one of these measures represents a dramatic break with the past, but the broad range and cumulative character of the changes leaves little doubt that the Korean economy is being liberalized.

The speed of change, to be sure, is less impressive. For example, the top management of commercial banks is government-appointed, and through strict controls on the ownership of bank shares the government retains effective control over lending policy. Import liberalization is proceeding on an accelerated schedule and safeguard measures are used very sparingly, but sensitive import categories continue to be protected by special laws and domestic content requirements. There is also a disturbing recent trend toward increased protection of agriculture.[7] A third example is the new industrial policy law, which replaces very detailed, sub-sectoral promotion laws. Importantly, the new law avoids any language or a mechanism for "picking winners". Nevertheless, it is vague about what forms of subsectoral intervention may or may not be practiced in the future, and provides for the creation of a Japanese-style system of sector-level "entrepreneurs associations" for guiding government industrial policy.

Flexibility and pragmatism are essential features of Korea's governing style and the government is liberalizing without burning its bridges. Like export promotion before, liberalization is being tried as an experiment, and will be pursued in a form that yields the most positive economic results. Korean planners are particularly aware of the disastrous experiences of Latin American countries which rapidly removed all constraints on trade and international capital flows.

There are also objective factors that argue for a gradual approach. Korean financial institutions are inexperienced, owing to the government's dominant role in credit allocation in the past. The stock market is thin, and nearly all corporate bonds are insured by the commercial banks. New sources of market information and confidence in credit markets has to be developed before they assume the full burden of determining Korea's resource allocation. The development of capital markets, in turn, is severely constrained by the tenuous financial position of companies that participated in unsuccessful HCI industries, and, more generally, by the very high debt/equity ratios of Korea's major conglomerates. All these problems, however, are becoming increasingly tractable under the extraordinary growth Korea is experiencing today.

Questions of pace aside, the market-oriented thrust appears to be permanent. To begin with, a powerful group of technocrats in the economic leadership (many with American PhDs) except the value of markets. Most see the HCI experience as evidence of the limits of government planning. But even those who view the HCI push favorably accept the need for reduced intervention. The economy is now much more complicated, and its leading firms are much more sophisticated, than under earlier policy regimes. At the same time, political constraints on economic decision-making have become important. Externally, Korea faces pressures from the United States for eliminating intervention and subsidies. Internally, it faces an increasingly pluralistic environment, in which selective intervention, particularly on the side of big business, is difficult. Many more interest groups are now lobbying for government attention and their interests often fail to coincide with national economic welfare. It is becoming safer to have the government's role circumscribed.

*The U.S.-Korean Relationship in the Future*

Korea's Sixth Plan calls for 7 percent annual growth, some reduction in international debt, and a continuation of the country's outward-looking development strategy. Without the recent depreciation of the won relative to the Japanese yen, a decline in interest rates, and falling oil prices, the simultaneous achievement of the plan's goals might have seemed improbable. However, with the help of these "three lows," Korean economic performance is well on its way to meeting government targets.

Why has Korea not used this opportunity to appreciate the won and increase living standards? These are questions of considerable interest to U.S. policy makers in light of their implications for Korea's current acount. The answer must be sought in both the internal political economy of debt, and in short-run macroeconomics. With respect to the politics of debt, it is a surprising but important fact that Koreans in all walks of life are extremely preoccupied with Korea's external debt, and were deeply shaken by Korea's close brush with a debt crisis in the early 1980s.

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[7] This trend is documented in various effective rate of protection studies, including K.S. Kim and S.D. Hong, "Long-Term Variation of Nominal and Effective Rates of Protection," Korea Development Institute, 1982, mimeo, and C.H. Nam, "Trade Policy and Economic Development in Korea," Korea University, 1985, mimeo.

Probably for historical reasons, external economic domination strikes raw chords in Korean consciousness. There was strong political pressure for reducing the debt burden even before the opportunity offered by the "three lows," when it appeared that debt reduction would entail a sacrifice in growth.[8] Thus it is not surprising that the government is using the present windfall to retire debt. From a macro-economic viewpoint, it is indeed difficult to see how further stimulation could be justified, given output growth in the 12 percent range. Unlike Japan, Korea is running a surplus while the economy is operating a full capacity—presenting a much more difficult problem in macroeconomic management.

Since the need for debt retirement and macroeconomic caution are likely to diminish with time, some revaluation of the won is eventually likely. Nevertheless, Korean exports to the U.S. are likely to grow and diversify. Korea's export structure has changed very rapidly in the past toward more advanced manufactures, and is likely to continue to do so in the future, since Korean wages are rising relative to those in other countries. Korea will move rapidly into more sophisticated markets and products, including those sensitive in American trade politics—consumer electronics, semiconductors, steel, and automobiles. Trade in textiles, apparel, and footwear is not likely to grow fast, but will remain important for many years to come.

A forecast of U.S.-Korean trade problems is beyond the scope of these remarks, but it is useful to touch briefly on three issues. First, it is likely that conflicts with Korea will not be as severe as those with Japan, not only because less trade is involved, but also because a substantial part of Korea's gains in American markets will come at the expense of other foreign producers (probably Japanese) rather than American producers. In the short run, this trend is supported by the sharp depreciation of the won relative to the yen. In the long run, it will be driven by the narrowing technological gap between Korea and Japan, and by American-Korean joint ventures that are strategically designed to counter Japanese competition.

Conflicts with Korea may be also less severe because Korean policy makers and entrepreneurs are extremely conscious of American concerns and are trying to avoid associations with the Japanese image through accelerated liberalization, direct investment in the U.S., buying missions, joint ventures, and the like. Some major exporters, such as Daewoo, are establishing close links with American companies to assure market access. The government, in turn, has launched a 1970-ish-sounding five-year plan to reduce the trade deficit with Japan, including incentives for "diversifying" imports from Japan to the United States and for "localizing" the production of components imported from Japan. In other words, Korea seems prepared to risk conflicts with Japan in order to avoid them in the United States.

Second, the future volume of U.S.-Korean trade will depend very much on the other outlets available for Korean exports. Korea's share of all U.S. imports as well as of all Japanese imports is around 3 percent, while its share of European imports is only 0.5 percent. One suspects that in an efficient world trading pattern the differences would be smaller. Favorable economic conditions, more open markets in Europe, and growing confidence in Korean products could reduce the present differential in the years ahead. In addition, as trade imbalances between the United States and Japan are gradually rectified, opportunities for Korean exports to Japan could expand. It is worth noting here that Korea, too, has a long list of complaints with respect to access to Japanese markets.

Third, on a less positive note, it is likely that much of tomorrow's U.S.-Korea trade will be settled at the negotiating table instead of the market place. Owing to its emphasis on light manufactures such as clothing, and high-volume manufactures such as textiles, steel, and automobiles, Korean exports are more protection-prone than the exports of any other major economy.[9] Already much of Korean exports to the United States are under quantitative restrictions, such as the multifiber and steel agreements. Other categories, such as automobiles and semiconductors, may be only temporarily free, judging by the history of Japanese-American trade in these products.

It would be desirable to have more market management and less political management of trade than is implied by the trends. But to the extent that future U.S.-Korean trade is managed, I would like to conclude by proposing three guidelines that would best serve the broad interests of the United States:

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[8] Two years ago, a frequent criticism of the Sixth Plan, especially from foreign economists, was that it envisioned too *little* borrowing in light of Korea's opportunities for investment and access to foreign capital.

[9] Calculations demonstrating this result are included in Peter A. Petri, "Korea's Evolving Export Niche," op. cit.

1. Korea should be treated fairly and sympathetically. Korea's economic performance is dramatic support for development through private enterprise and hard work. If American markets remain open to Korea, other developing countries will be encouraged to adopt a market- and trade-oriented development strategy. Korea should not be caught in the struggle over U.S.-Japan trade, since Japan's level of development, economic structure, and trade policies are very different. At the same time, the United States should forcefully advocate the continuation of Korea's liberalization effort and urge progress in agricultural and service trade.

2. Korea's competitive pressure on Japan and other producers of modern consumer goods should be preserved. Competition from Korea in a wide range of products, including automobiles, consumer electronics, and semiconductors, is providing immense benefits to American consumers. The management of trade in these and other categories should not permit Korean companies, in collaboration with other multinationals, to raise prices of American imports. Instead, U.S. policies should encourage U.S.-Korean joint ventures that effectively compete with Japanese and other multinational firms.

3. Korea's share of U.S. markets should not be protected against competition from other developing countries. Due to rising labor costs, Korea is losing comparative advantage in various labor-intensive manufactures covered by bi- or multilateral agreements. Countries other than Korea should have the same chance that Korea had to develop American markets if they can serve these markets on the best available terms.

If political conditions are favorable, there is little doubt that U.S.-Korean economic relations will prosper in the future. So far, both sides are adopting policies that are conducive to the healthy growth of this trade. But the negotiators' goodwill will be increasingly put to test as the trading relationship matures, and I expect the future of the U.S.-Korean economic relationship to be exciting as well as mutually rewarding.

Mr. AHEARN. Thank you, Peter, for peeling that onion for us, and also for sparing us from a presentation of your regression equations.

Our next speaker is Dr. Eul Park, and I am going to challenge the next two panelists to try to limit your remarks to 10 minutes or less, because we are running late and we do want to have an opportunity to give John Bennett a chance to discuss and comment on your presentations.

## STATEMENT OF EUL Y. PARK, CONSULTANT, THE WORLD BANK, AND LECTURER, GEORGETOWN UNIVERSITY

Mr. PARK. Well, when I agreed to present at this session, we discussed, you know, how we sort of divide our share, you know, a nice division of labor among the panelists. And I understood that Dr. Kim tried to do a macroeconomic aspect, and Dr. Petri on macroeconomic aspects. So I agreed to approach this competitive aspect.

Another reason why I think it is a good idea to look at Korea from sort of the more competitive aspect is that now it seems to me that journalistic accounts create a picture of quite a unique case. Actually, if you look at it pretty closely, what is happening in other so-called newly industrializing countries, Korea is not so unique. I can give you one example. You know, Korea is reputed as a country which first successfully exported the automobile into the U.S. market, but, as you may know, Yugoslavia is one country, and now the automobiles are manufactured in Mexico and they are coming to the U.S. market, and Brazil is another one. And Malaysia is thinking of sending their automobile to the United States market and maybe some other markets.

So it is very important for the United States to think not as a Korea but as a country like Korea, how to deal with that kind of problem.

And there is another aspect, another reason why I decided this is a good opportunity to talk about this competitive aspect, that is, whenever there is a policy planner at the Congress or U.S. administration or any other occasion talk about Korea, they usually talk not about Korea, but about like the "gang of four," or Taiwan and Korea, or Japan and Korea and Taiwan, et cetera. And, although there are significant differences among them in terms of the situation they are facing in this issue area, as well as similarities, I decided to speak on this issue. I will try to talk very briefly about these things and the many things that I will not speak about today will be contained in the written paper I will present later.

As you are well aware, in the 1950's and 1960's, there were about a dozen countries among about 140 developing countries which had succeeded in maintaining a relatively high rate of growth through the industrialization, which we call the newly industrializing countries. They include Mexico and Brazil in Latin America, and Korea, Taiwan, Singapore, Hong Kong in Asia, Israel, Yugoslavia, Greece, Spain, Portugal from Europe and the Middle East. And it depends on how you look at it—some people add some other countries, some people do not add other countries. So there is no clear definition. The countries I mention usually are included in the list.

And some common factor which is important to explain this remarkable sustained high economic growth I found is—one of the most important common factors I found is level of education and the development of human resources. If you look at these statistics in the 1950's, which are available in UNESCO statistics or UN statistics, you will find that those countries, the level of education is much, much higher than all other developing countries, although they are understandably lower than the industrial countries. For example, by the middle 1950's, the percentage of Koreans who have not gone to school is about 5 percent, according to the recent World Bank statistics. And Taiwan is slightly higher, and Brazil is a little bit higher.

But compared to average LDC percentage, which runs about 50 to 60 percent, it was much, much lower than the average LDC, and, as you can imagine, the direct and indirect contribution of this high level of education and human resources development to industrialization is very, very significant.

The second thing I'd like to mention, the common aspect, is that all of these countries are more open to the international relation of their economies than the other countries. What I mean is, whenever they need technology, they try to get it from an industrial country rather than try to re-invent the wheel, and whenever they need capital to close the gap between investment and savings, they come to the industrial countries to borrow. Of course, there is a significant difference, which I will mention later, among some Latin American countries who pursued import substitution in their industrialization strategy versus the so-called export promotion industrialization strategy the Asian countries adopted.

But overall the industrialization policy is sort of open-market-oriented, I would say.

And another common factor is that this high level of economic growth was through structural transformation, mainly industrialization. So all these countries which were sort of centered on primary sector activities in the 1940's and 1950's gradually shifted to manufacturing-sector-centered economy, and the proportion of GNP and also the level of employment which is in the manufacturing sector grew very fast.

Since they are follower countries, the loaning effect is very, very important. And this is very closely related to the first factor I was talking about, the development of human resources. Those countries which had a higher level of education could learn better, of course, and the direct result is that productivity growth was tremendous compared to the other countries.

And the next common factor I'd like to mention is the role of the activist government. Professor Petri mentioned Korea being an activist government, and there's no question about it. When I talk about activist government, people usually tend to see government replacing the market; they also tend to think about the government putting up subsidies, giving subsidies to inefficient industries, etcetera. I don't mean that kind of activist government, but rather the government tries to correct market failure, and a strong government can stand up under unpopular policies, such as land reform, devaluation, and stabilization policy which can hurt many interests. Without this kind of strong government, all NIC countries, I think, would not be able to perform nicely in this economic sphere.

I would like to remind you that Mr. Dick Cooper, who wrote an article, a very interesting article, a long time ago, about the relationship between devaluation and political stabilization. He found that of those countries that devalued, the government just fell within one year in about 50 percent of the cases. That was very interesting.

The next topic I would like to mention is the differences. In differences I want to mention the Latin American type of newly industrializing countries versus the Asian type of newly industrializing countries. Professor Kim mentioned very nicely about this linkage between stabilization and liberalization, comparing the Latin American and Asian cases—and I don't want to spend time on it. But mostly the kind of thing I would like to concentrate on is this export-oriented policy versus import-substitution policy.

As you already know, the export-oriented policy was much more effective in promoting economic growth than the import-substitution policy. And many economists spend time to find out why that is the case. They learn that the export-oriented policy was much less distorting in many macro policy areas; for example, the real exchange rate was much more in equilibrium in the export-oriented strategy than the country which adopted an import-substitution industrialization strategy, because the import-substitution industrialization strategy tends to have more an overvalued exchange rate. And, as far as protection level is concerned, as Dr. Petri mentioned, the oldest export-oriented country, their export sector was completely liberalized and they were running under a free-trade regime, which is the case of not only these NIC countries, but also all the countries, including the United States—and that is permis-

sible under the GATT rule. What I am referring to is the tariff exemption or the tariff drawback and the indirect tax exemption and drawback.

And the second factor why the export-oriented economy did better than the other type was that they found that in the import-substitution industrialization strategy, the country which adopted that strategy did much more so-called rent-seeking activity, or a certain activity which is related to unproductive profit-seeking activity. I don't have to go into that, because you would understand what that means. But this is much more prevalent in the countries which pursued an import-substitution industrialization strategy.

And export orientation gave a much more efficient resource allocation, which you can read about in the textbook, which is a neoclassical kind of theory I'm talking about here.

So the Asian countries which adopted export-oriented policies performed much better, and that's a very, very important lesson we can draw. And gradually Latin American countries are sort of shifting their policies toward that policy, toward the export-oriented policy.

And the second aspect of the differences among NIC's, I want to concentrate on Taiwan and Korea. If you look at the development history of Taiwan, it is an amazing country; they have done many things right, until recently, and, if I want to find out a note of things they didn't do right, the first thing is that they were very reluctant to adjust when they encountered this structural problem—what I am talking about is the structural problem of their foreign sector. As you know, they have accumulated the current account surplus more than ten years, and now their reserve runs among the highest in the world, about $50 billion.

And another thing that I don't find about Taiwan particularly enviable is still the important role of the public sector, whose output is around 20 percent of total gross output. So the public sector's role is still very, very important and strong.

And, except for those two cases, many things Taiwan has done are very interesting, and they have done many things right. Taiwan in the early fifties—actually in the late forties and early fifties—set stabilization as their primary goal, not high growth. So at that time they had a very high nominal interest rate which was the positive real interest rate, and that helped increase domestic savings significantly, and early on they didn't have to rely too much on foreign borrowing to close the gap between investment and savings.

I've got a note that I have to stop. So let me just quickly summarize the differences between Taiwan and Korea, then we'll spend a couple of minutes on a concluding remark.

But in the case of Korea, Korea accepted high rapid growth as a primary goal rather than stabilization, and the Korean government thought a little bit of inflation—actually, that's a double-digit inflation, not a little bit—but inflation is sort of the kind of price they have to pay for rapid economic growth. Because of this different philosophy they had pursued a long time, like twenty years or so, what now they are facing is quite different, although Korea has sort of repented of its sin from 1980 on. Korea now does much better in terms of this economic stabilization, and also the domestic

savings rate, etcetera. But, you know, the accumulation of the past sin and those differences between Taiwan and Korea in the last two decades are really staggering. That explains why Korea became the number four country in terms of the debt level after Brazil, Mexico, Argentina, and, in per capita terms, Korea's debt level is even higher than Brazil's. I understand why Koreans are very worried about this debt level, and many people worry if another oil crisis should come or a higher level of international interest rate, that will have a disastrous effect on the Korean economy.

And let me just spend a couple of minutes on this concluding remark. Now, what can we learn about the competitive approach in economic growth of NIC countries, Korea in particular? I would like to mention the so-called export pessimism which is coming up again whenever they read about a new protectionist measure adopted by industrial countries. There is certainly a very high uncertainty as to whether or not the export-oriented policy will succeed, and not only government officials but also scholars are now thinking in a very dubious manner whether it is a good idea to preach an export-oriented development strategy to developing countries.

And my own view is that the export pessimism is really in some sense a misconceived idea. The reason why I think that export pessimism is not necessarily well-grounded is that those people who think that an industrial country would not be able to absorb the kind of export product coming out of the export drive of many developing countries, not to mention just this "gang of four," they ignore many things, like the initial conditions of many of the LDC's are so different and not all of them will come as an export-oriented economy like the "gang of four." So just an extension of the experience of the "gang of four," sort of generalizing the experience which could be emulated by other countries, would be totally wrong.

And, secondly, the export-oriented economy will import significantly. The kind of adjustment problem now the Japanese economy or the Taiwanese economy has is simply an adjustment problem; it is not really directly related to export-oriented policy. That's what I want to argue.

And, thirdly, as they come into a more export-oriented policy, there is a lot of trade among developing countries, and that the export pessimists usually ignore.

Just two more very quick comments, concluding comments. I think it is very, very important for all these NIC countries to participate more actively in MTN or any other fora of international trade in order to promote and contribute to maintain a liberal international economic order. That's very important.

And so they have to not only try to adjust whatever structural adjustment problem they have, but also encourage other countries to contribute, so that the other countries which have structural problems, especially in their external sector, will adjust to that kind of problem.

And, finally, this kind of adjustment would not be necessary on the part of the NIC countries but also, more importantly, the United States, because the United States, after all, is the main

country which will determine eventually the course of the liberal international economic order.

Thank you.

Mr. AHEARN. Thank you, Dr. Park. You didn't quite meet your 10-minute target, but I'll give you an "A" for trying. Our last speaker is Dr. Kim.

## STATEMENT OF DUK-CHOONG KIM, DIRECTOR OF THE RESEARCH INSTITUTE FOR ECONOMICS AND BUSINESS, SOGANG UNIVERSITY, SEOUL

Mr. DUK-CHOONG KIM. This paper attempts to develop new approaches to relationships among political, military, and economic factors affecting the Korean peninsula, by looking closely at connections between national security and economic growth. I hope in this way to promote better understanding of current economic problems between the Republic of Korea and the United States. In looking at these questions, I focus first on South Korea's own economic situation. I then review Korean-American economic relations, with special attention to trade issues. Keeping in mind the limited role that governments can play in solving trade problems, I emphasize the potential of private enterprises to promote economic cooperation between the two countries.

Once thought to be impossible, South Korea's achievements in economic development now appear to be taken for granted. This is due, in large part, to the extensive coverage given to Korea in recent years by the world press and to the increased attention paid to Korea's postwar development by western academics. Also almost as remarkable as the economic growth itself is the fact that this growth has been accompanied by an increasingly equalitarian income distribution, a pattern that many economists once considered beyond the reach of any non-communist developing nation.

In my view, speaking both as an economist and as a Korean in his early fifties who has participated in the economic transformation of his country, two factors seem to be of greatest importance. The first is our human resources. Like the other equally successful newly industrializing countries of Asia, Korea almost totally lacks natural resources. With manpower for all practical purposes its only resource, Korea was forced to make efficient use of this asset. Very fortunately, we have done so. Secondly the continuous threat to our physical survival posed by North Korea has helped motivate the south to achieve rapid economic growth.

Consequently, the existence of the external threat is important to understanding Korea's progress over the last two decades. In analyzing that development, I include seemingly non-economic factors in order to show how this threat has affected our economic progress.

Korea's national security has greatly influenced, and at the same time been considerably influenced by, a complex interweaving of social, political, and economic factors. The external threat is of course the clearest single factor affecting national security policy. But both the immediate and the less immediate threats fit into a broader international economic and political context.

The social health of society requires some degree of consistency between aspirations and accomplishments, and between feelings of entitlement and their fulfillment. These depend on the nature of relationships between people at various levels of society, and these in turn are molded by beliefs about what is right, desirable, and just. Political institutions function well or badly, depending on how they are used to direct resources and regulate relationships. On these criteria, authority is judged to be legitimate and just or imposed by force. Such considerations are clearly reflected in the nature of political governance.

In the scheme of development, history shows that the availability of natural resources is not an absolute necessity for economic development. Nations such as Japan and Switzerland have amply demonstrated that the proper combination of will and skills can make up for an absence of resources. Korea has now reinforced this point. To some degree, the experience of other developing nations also supports this contention. What distinguishes the Korean experience, however, is the degree to which non-economic factors have had a direct effect on economics. This phenomenon is ignored by most theories of economic growth.

Korea's consistently high economic growth rates—averaging 8.2 percent between 1962 and 1985—were in large part achieved by setting seemingly impossible goals. A "sensible" target, given the domestic resources then available, particularly the low level of domestic savings, would have been annual growth rates of about 3 percent. But the decisions to set targets were made largely on political grounds, which, in turn, were largely based on security considerations. First, rapid growth was essential to bearing a heavy defense burden in response to the constant threat from North Korea. Secondly, a high growth rate was needed to keep the unemployment rate below 6 percent, which Korean leaders believe is the maximum level consistent with economic and political stability.

Professor Dwight H. Perkins of Harvard University has argued that political stability is a key prerequisite for continued economic growth by developing nations. Social stability has been essential to political stability, which in turn has been essential to economic growth and to national security. Conversely, national security has been needed to maintain political and social stability and economic growth. National security needs, having been given top priority, have been a powerful stabilizing force in Korea. In other words, the establishment of high economic growth rates as a national goal was a political decision based on national security considerations.

This political decision has been dramatically successful. Even during the early 1980's, when both domestic and internal conditions were more unstable than in earlier years, Korea was able, after negative growth in 1980 (because of President Park's assassination in 1979), to maintain an overall growth rate of 7 percent.

Domestic savings were insufficient to finance the high rates of economic growth discussed above. Consequently, Korea had to rely for many years on foreign capital. During the first Five-Year Economic Development Plan (1962–1966), domestic savings were 8 percent of GNP, and some 60 percent of investment came from foreign sources (by 1985, the latter had declined to 10 percent). However, because of Korea's previously large dependence on outside sources

for growth financing, its foreign debt reached the neighborhood of U.S. $46.8 billion in 1985.

In view of Korea's low domestic savings rate, this high foreign debt level has been unavoidable. Korea's debt service ratio is currently about 18.5 percent, and this ratio is expected to fall steadily over the remainder of this decade. But, including short-term interest payments, the debt service ratio was 20.1 percent in 1984. In the prevailing uncertain international economic environment, foreign debt is an obstacle to the conduct of effective economic policy.

Fewer foreign loans and a lower foreign debt were technically possible, but would have resulted in lower rates of growth, which would have had adverse consequences for national security. Thus Korea's high foreign debt, as well as its high growth rates, have been directly related to national security considerations. The debt has, of course, been a burden, but the price of not incurring it would have been even greater than this burden.

A comparison of savings rates, including household savings, among the Republic of Korea, Taiwan, and Japan illustrates the unique relationship between economic development and national security that has prevailed in Korea during these past two decades. The domestic savings rate and the household savings rate in Japan in 1982 were 31.2 percent and 12.5 percent, respectively. Those rates in Taiwan, for the same year, stood at 30.4 percent and 13.8 percent. However, Korea's domestics savings rate in 1982 was considerably lower, 22.4 percent; and the household savings rate was only about half those in the other two nations. Nevertheless, the governmental and corporate savings rates were similar in the three countries.

The reason for this discrepancy lies in considerations of national security. As early as the 1960's, some South Korean economists realized that a high growth strategy would invite a certain degree of inflation; yet national security considerations made rapid growth a necessity, even at the price of high inflation. But when the "oil shock" hit, Korea, as an oil-importing nation, was unable to avoid greatly increased inflation in the short term. The second "oil shock" in 1979–1980 further handicapped our efforts to curtail inflation. And throughout, as a direct result of the continuing threat from North Korea, South Korea incurred very considerable defense costs. While inflation has fortunately been greatly reduced in the last few years, the 20-year period of high growth was marked by high inflation that undermined household savings. In short, Koreans have had to pay a price in numerous ways to protect their national security, and the country's economy has largely responded to the priority that national security has enjoyed over all other goals.

In terms of trade volume, the United States is South Korea's most important trade partner, while Korea is the seventh largest trade partner of the United States. Trade between the two countries has grown in recent years from U.S. $3.4 billion in 1975 to U.S. $16.2 billion in 1985, a five-fold growth in current dollars. If this trend continues, the two countries will become even more important to each other in the years ahead.

However, the Korean-American story far transcends the basic statistics of trade volume.

The average annual growth of U.S. exports to South Korea during the 1975–85 period was 13 percent. The growth of U.S. exports during these years exceeds the comparable figures for Japan (9 percent) and Taiwan (11 percent). Furthermore, the average annual growth of the U.S. exports to EC countries (7.4 percent) and Canada (8.1 percent) was smaller than to Korea. If U.S. exports to Korea continue to expand at the pace attained for 1975–85, they will reach U.S. $11 billion by 1991.

On the other hand, total Korean-United States trade over the past 20 years resulted in a positive U.S. balance, even though Korea has shown a surplus in recent years. Korean exports to the United States in 1984 totaled U.S. $10 billion, while imports from the United States amounted to U.S. $6.5 billion, leaving a balance of U.S. $3.5 billion in Korea's favor; in 1985, Korea exported U.S. $10 billion to the United States, while importing U.S. $6 billion, leaving a trade balance of U.S. $4 billion in Korea's favor.

But when services and transfers are included, Korea runs a considerable deficit. Assuming that one-third of Korea's aggregate foreign debt is owed to U.S. lending institutions and an average interest rate of 10 percent, a rather conservative figure, annual interest payments to the United States amount of about U.S. $1.2 billion.

Additionally, Korea in 1983 purchased U.S. $673 million worth of construction-related equipment and materials from the U.S. that were destined for third nations, and another U.S. $556 million worth in 1984.

More and more economists are reaching the conclusion—and trying to convince other policymakers, political leaders, and the general public—that merchandise trade balances are much less important than current account balances, which encompass goods and services. Moreover, as the United States, Japan, and other advanced countries lose their comparative advantage in basic manufacturing industries, it is only natural for them to keep their overall balance of payments accounts in rough equilibrium by developing greater capabilities than before in tradable services.

Economists used to think that services were inherently less tradable than goods. However, we Koreans are witnessing a steady stream of visiting American consultants, lawyers, investment bankers, advertising copywriters, design and quality control specialists, and sometimes even strategic studies scholars. The proliferation of such non-Korean experts in Seoul brings what we who pay their fees think of as enormous benefits to the United States current account balance. We find it hard to imagine that advanced countries lack the dynamism or skills they need to survive against competition from newly industrializing countries like Korea.

Insofar as the merchandise trade balance remains significant in itself, Korea is often unfairly compared with Japan and Taiwan. In 1982, Taiwan had a U.S. $3.4 billion merchandise trade surplus with the United States, and Japan a surplus of U.S. $12.4 billion; Korea's surplus, however, was only U.S. $0.1 billion. In 1985, Taiwan's trade surplus with the United States reached U.S. $13.1 billion, and Japan to U.S. $49.7 billion; by contrast, Korea's surplus was only U.S. $4 billion.

Also Korea's share of the U.S. market is lower than those of Japan and Taiwan. Thus from 1979 to 1985, Korea's share of the

U.S. market rose a mere 0.9 percent, from 2.0 to 2.9 percent. During the same period, Japan's share of the U.S. market rose from 12.7 percent to 20 percent, and Taiwan's share rose from 2.8 percent to 4.9 percent. To be blunt, Korea's increase was insignificant by comparison.

In terms of both resource endowment and stages of economic development, Korea and the United States have a relatively complementary industrial structure. Thus Korea is now moving into industries that are declining in the United States. Korea's major imports from the United States include not only capital-intensive technology products such as chemicals, chemical products, airplanes, and sophisticated machinery, but also such agricultural commodities as wheat, corn, and cotton. In 1985 Korea purchased from the United States U.S. $1,434 million of chemical and chemical products, U.S. $2,557 million of machinery, and U.S. $1,018 million worth of agricultural products.

Korea's major exports to the United States include textiles, electronic products, footwear, iron and steel products, and automotive parts. As of 1985, Korea exported U.S. $2,599 million worth of textiles and U.S. $2,348 million worth of electronic products to the United States. In the coming years, Korean exports of consumer electronics and automotive parts will be increasingly important.

In particular, Korea has in recent years ranked as the fourth largest buyer of U.S. agricultural commodities. As of 1985, Korean agricultural products imports from the United States accounted for 60 percent of its total agricultural imports.

Meanwhile, the Korean government is pursuing an active import liberalization policy that has not gained the attention it deserves abroad. The motivation for doing so is the same that prompts the United States to maintain a generally free trade policy, namely, to improve the efficiency of domestic firms and to maintain competitiveness in the world market.

Recent data demonstrate the Korean government's determination to pursue this policy. Korea's import liberalization ratio was 52.7 percent in 1977; it climbed to 80.4 percent in 1983. The government has plans to increase this ratio to 95 percent by 1988. Also Korea's average tariff rate was 22.6 percent in 1983; the government has recently announced plans to cut this rate to 16.9 percent by 1988.

During the period from 1962 to 1985, Korea attracted about U.S. $586.7 million in direct investment from the United States.

During the period from 1962 to 1985, the United States accounted for 32.1 percent of total direct investments made in Korea, while Japan accounted for 47.4 percent. This long-term trend reflects Japan's geographical proximity and the large number of investments made by small Japanese firms and Korean residents of Japan, mainly in component manufacturing facilities and trade. U.S. investments, by contrast, have tended to be fewer but concentrated in large-scale "big-ticket" items. These trends may be changing, however. In 1985, U.S. investments accounted for 47.8 percent of total foreign investments in Korea. This growing U.S. role is most welcome, and we hope that this trend continues. We are well aware of the danger of relying too much on any one country for

foreign investment, not to mention our historical concern about an excessive Japanese presence in Korea.

The South Korean National Assembly passed a series of measures in December 1983 designed to make it easier for U.S. firms to make investments in Korea. These measures include a vast reduction of the red tape required for approval of such investments, especially technology transfers; a marked expansion of the categories open to foreign investments; and considerable relaxation of restrictions on foreign investments, including equity participation.

At the same time, Korean investment in the United States has been growing. Korea has invested U.S. $60 million in the United States during the past six years, U.S. $21 million in 1984 alone. This trend will continue in the coming years, as overall economic ties between our two countries grow.

At this stage in its economic development Korea should acquire more advanced technology to achieve the high level of growth required by national security considerations. Much of this technology will be in the form of foreign direct investment from the United States, Japan, and elsewhere.

As of 1985, the United States accounted for only 23.3 percent of total technology transfers to Korea, but the U.S. share of the 1985 flow into Korea was 25.1 percent. For these transfers, Korean firms paid U.S. firms U.S. $155 million in 1985. Total payments to the United States for technology transfers between 1962 and 1985 came to U.S. $599 million.

Twenty-seven percent of Korea's total foreign loans came from U.S. sources between 1959 and 1982. More recently, the 1983-85 period, 24 percent of total loans were from the United States; the United States is the largest single source of such lending.

If one takers an all-inclusive approach to Korean-American economic relations, encompassing trade, direct investments, technology transfer, and lending, it is apparent that a healthy and continually growing relationship is under way, which is mutually beneficial. And the relationship is becoming increasingly multifarious.

Let us focus now on the Korean entrepreneurs who are the main actors in the development of Korean-United States economic relations.

The occupation of Korea by Japan from 1910 to 1945 stifled any potential entrepreneurial class in Korea, and the Korean war of 1950-53 had devastating effects on all sectors of Korean society. When South Korea began its industrial development efforts in the early 1960's, entrepreneurial power first emerged in Korea. Korea's industrial and economic take-off was due largely to joint government-entrepreneurial efforts; in the later stages of this process, genuine entrepreneurs gradually played a more crucial role in the development of the economy.

In order to understand the growth of entrepreneurship and the role of entrepreneurs in Korea's economic development, the various stages of Korea's economic development must be understood. And the dynamic growth of the Korean economy during the last two decades cannot be appreciated without some knowledge of the situation that existed before economic development began. The short-lived ecstacy of liberation in 1945 was followed by division of the nation and then by a war that left the country, the economy, and

the national psyche traumatized. In addition, millions of refugees from the north exacerbated the employment problem. The nation was stunned, and the economy was isolated and stagnant after war ended in 1953. The annual average rate of inflation between 1945 and 1955 was 108 percent, and capital resources were non-existent.

In 1961, per capita income was U.S. $85, and the domestic savings rate was 3 percent. Korea launched its ambitious first Five-Year Economic Development Plan in 1962, when total exports were a meager U.S. $55 million. By 1986, per capita income had reached U.S. $2,271, the wholesale price index was down 2.2 percent from 1985, and the consumer price index registered a 2.3-percent increase. The domestic savings rate had climbed to 33 percent. Exports were U.S. $34.7 billion and imports U.S. $31.6 billion, a total of about U.S. $66.3 billion. The economy had been transformed from stagnant isolation into open dynamism.

In the 1950's, the only major domestic industries were food and clothing. With social conditions uncertain due to the aftermath of the Korean war, entrepreneurs were making no industrial investments; the focus was on speculative short-term investments in the commercial sector. In short, entrepreneurs hardly existed, but merchants were quite numerous and influential. The primary concern of the government, the merchants, and the populace at large was basic survival amidst the ruins of war.

Things began to change in the 1960's. For the first time, the government made capital available to entrepreneurs, who eagerly grasped the opportunity to begin western-style enterprises. At the same time, the government's policies were affecting such non-economic factors as the continued confrontation with the North Koreans and the increased social mobility brought about by expanding economic opportunities. All these policies were affecting entrepreneurs indirectly, and the government was also having direct effects on entrepreneurs, for example, the government's planning resulted in increased entrepreneurial risk-taking in such areas as export-orientation and development of heavy industry. Heavy and chemical industries began to expand while export emphasis was still geared to such light industrial products as textiles.

During the 1970's, change became more pronounced as a result of government policy; especially during the latter half of the decade, various industries moved toward industrialization. But during this period the government, as we shall see, had its greatest impact on non-economic factors. In the economic sphere, the government began to establish technical schools and training programs for the rapid development of heavy industry. These technical institutions were established and run by the government for industries that were unable to establish their own programs. Simultaneously, through government regulation, the larger companies were required to set up their own schools and institutes to train manpower for activities in such increasingly important fields as heavy industry and overseas construction. Also during this period the government began to target more funds for such specific areas as heavy industry. General Trading Companies were established as a matter of government policy in order to expand markets abroad and to make Korean enterprises more credible on the world market. As planned, Korean GTC's played an important role in promoting ex-

ports. The share of heavy chemical industry goods exports accounted for by GTC's is greater than the national average; it increased from 23 percent in 1976 to 74 percent in 1984. It seems clear that Korean GTC's played a positive role in economic growth: exports have constituted about half of total economic growth during the last two decades. In R&D the government began to establish institutes in cooperation with the private sector.

In the non-economic area government during the 1970's was favorably affecting the legitimacy of entrepreneurs, by giving them more recognition and respectability; as a result, the social status of entrepreneurs rapidly improved. The government, for example, established an annual National Export Day and made awards to companies that were making the great contributions to the export drive. The custom of looking down on businessmen rapidly disappeared. In the area of ideology, the government was beginning to force businesses to go public, which led to the gradual replacement of "family" firms. The government also began to encourage the establishment, by expanding companies and business conglomerates, of foundations dedicated to the general welfare of Korea. In this way, corporations were guided toward greater social responsibility. The government's greatest effect during the 1970's was in the non-economic realm, and the most farreaching program was the Saemaul (New Community) Movement in both rural and urban factories. This highly successful program linked such important factors as national identity, motivation, and achievement orientation. It continues to operate today.

There is no question that economic development in Korea has been government-led. But at the same time development has largely been driven by private companies in a "concerted free enterprise system." This system differs from the "purer" form of free enterprise in the degree of harmonization of economic objectives within the business community and the amount of consultation among business, government, and, in some cases, labor leaders. In this way, the country sets national economic priorities and pursues national economic objectives without resorting to government fiat or the administrative allocation of resources. In Korea, government policies have made their weight felt, but what has emerged over the years is a highly cooperative relationship between government and the private sector.

In the early stages of the economic development of South Korea, government administrators were an elite group that, because of the anti-commercial bias of traditional Confucianism, tended to denigrate business activity. They were also inclined toward centralized government. Yet the sheer necessity of achieving higher rates of economic growth in the face of the external threat changed this relationship. As the private sector became larger, government officials were forced to adjust their attitudes toward the business sector. For example, the annual sales of one large business group were nearly equal to the entire government budget.

The rapid changes in Korea in the recent past have made an uncertain world even more uncertain. For example, in view of recent changes in our political structure and the rapid evolution of the world economic environment, one can ask whether Korea is still

characterized by government dominance of the business-government relationship. My response follows.

In the first place, economic efficiency must have top priority in contemporary Korea, if we are to overcome unfavorable internal and external economic circumstances and maintain a high rate of economic growth. This means that, to some extent, the basic thrust of economic policymaking has shifted gears: a gradual transition from government-oriented decisionmaking to private initiatives based on the free market mechanism is needed for the sake of economic efficiency. For example, the government cannot lead the way in international marketing, due to its lack of entrepreneurial know-how. The high degree of openness in the Korean economy—80 percent during the Fifth Five-Year Economic Plan—implies that internationalization of Korean enterprises is of paramount importance. This also means that international marketing has enhanced importance. Since the government cannot see to it that Korean products reach the world market, this responsibility devolves upon the private sector.

In the second place, direct financial support by the Korean government for exports is at a critical juncture. Korea's total exports reached U.S. $35 billion in 1986. Korean firms have become so large that export subsidies are nonsensical for today's Korea. If subsidies were 10 percent of exports, they would reach U.S. $3.5 billion: deficit spending on this scale is ruled out by its inflationary consequences. And it is obvious that Korea has graduated from the traditional group of developing countries: the advanced countries have awarded us a diploma in recognition of our economic development. Indeed we are a Newly Industrialized Country. This status rules out reliance upon export subsidies. Furthermore, any kind of export subsidy can bring about retaliation by the United States.

Thirdly, Korea's political evolution calls for new approaches in economic policy. Regardless of whether Korea opts for a presidential or parliamentary system of government, the size of its constituency is going to be vastly larger than it is at present. The government will have to be more responsive to the popular will, and the market can supply a means to accomplish this.

Fourthly, the life cycle of commercial products is becoming shorter (normally five to ten years) due to the rapid pace of technological change. Indeed, the life expectancy of electronic products is now only three to five years. Only the private sector is equipped to deal with this challenge efficiently.

To summarize my position, the specifics of Korean reality add up to a solid argument for a smaller government role and more emphasis on the market place in directing the economy. Fortunately, Korea is already supplied with a new generation of entrepreneurs whose initiative and efficiency are the engine of our economic growth. Traditional entrepreneurship is changing as we see more joint ventures between companies, industries, and countries. The advent of a better-trained and a more dynamic generation of managers and engineers is one of the most promising features of the new Korea. These trends should make it easier to deal with Korea-United States trade tensions during the next few years. Indeed, I expect the economic relations between our two countries to prosper as never before during the next decade.

Thank you so much.

Mr. AHEARN. Well, thank you, Dr. Kim, for your candid remarks.

Now we turn to John Bennett for his thoughts on this morning's speakers.

Mr. BENNETT. I'm going to be very brief. I wanted to admit from the very beginning, or state from the very beginning, for those who don't know it, that I am a foreign agent registered, therefore nothing I say is to be taken seriously. [Laughter.]

And that's fortunate, because then I can be really irresponsible.

First, it occurs to me that one has to put all of this, our Korea-United States relation, in the context which we all in this room at least are concerned with, and that is the U.S. problem, a current account deficit of rather magnificent proportions. That's one way of viewing the problem. And I think one of the conclusions one has to draw is that none of the things we have said is basically going to change that.

A second conclusion is that, if you look at the overall problem, and if you have read the Wall Street Journal in the last couple of weeks, you will have noticed an article that talked about over-capacity on a worldwide basis in twelve large industries—Japan and the United States were mentioned in all of them; Japan, United States, and Korea were mentioned in eight of them, and should have been mentioned in all of them.

There is an adjustment problem out there, and it's coming. That's the context in which we are talking about some of these others things.

I think then we have to start asking ourselves what do we mutually, the United States, Korea, et cetera, really want in the way of this relationship. And one of the things that I think you would have to go back in again and sort of look at is the liberalization process that has occurred in Korea. And I think there is still a disjoint between the United States and Korea on that issue. There is a negative list—it keeps getting smaller. Nevertheless there also is a tariff system which has the effect of keeping out some of the imports, and I think one has to look at both of these barriers when he talks about this. And I think one has to ask himself, for example, why there are so few consumer goods imported into Korea. Five percent of the government list of imports is consumer goods, and another 5 percent are foodstuffs. But foodstuffs are not in the same sense consumer goods, and I'm talking about they are wheat, they are corn, they are raw materials.

The third thing I wanted to mention was that there seems still to be an unresolved dilemma. I listened to my friend, Dr. Kim Duk-Choong, talk about the rise of the private sector. I look, however, also at what the government talks about—now, this may be truly hortatory, but it's there. You have an industrial development law which consolidates the other industry development laws, these specific industry development laws in the past. There is still the concept of sunrise and sunset industries. This is still being worked out in terms of the implementation, but there is a law there. One can take two different points of view of this kind of industrial targeting. Some people think it's an adversarial result in a trade relationship; other people say, well, look at Korea—it's 40 million people, it's a very small economy, it has choices to make; if it's

going to survive in a world economy, it has to make good choices. And this process in Korea seems to have worked reasonably well through the last 25 years. I might even argue with some of the people here that the choices that were made in the late seventies weren't all that bad. They got caught by the oil shock and some other things; there may have been some macroeconomic policy errors made at the same time—and I certainly would agree with that. But there is a case to be made for the kind of industrial development strategy that Korea has followed.

You know, one can argue that the business and government relationship should be more adversarial in Korea—I wonder if we really believe that.

The issue of exchange rates—I went the other day—you know, we've got dangers on both sides of this one—I went to listen to a talk the other day where Williamson and Belasso were talking about a study they've made which ends up with the conclusion that Korea, Taiwan, Singapore, Hong Kong, should all revalue by 10 to 20 percent and continue to run current account deficits, or, if they haven't been running them, they should. And I was struck by the fact that—each country spoke about a specific chapter and gave very good reasons why it shouldn't do it. Well, there is an adjustment problem there for each of those countries, Taiwan, Korea, Singapore, and Hong Kong—and it will have to come sooner or later.

The other side of that, however, is that the United States also has an adjustment problem, and it happens to be right across the street in a budget, and it may apply elsewhere as well but it certainly has to start there, because the current account deficit is almost by definition, but also by the operation of the financial markets, a function of the capital inflows into the United States.

I want to go back and simply sort of end this by observing that I constantly get the feeling that the relationship is in serious trouble not because we've got major issues but because we are being pecked to death by ducks in the ankles on these little things, and that we have to go back and rethink what are the really important relationships that exist and the important decisions that we have to make. And I hope that we are able to get to those when we worry about the relationship between Korea and the United States, which I feel, continue to feel, has a great future, as it has had a considerable past. It is the one country in which I served in my twenty-six years in the Foreign Service which I would call an almost unqualified success.

Mr. AHEARN. Things were a lot easier in those days, John.

We have approximately seven minutes now for questions, because we are going to adjourn promptly at noon. Please address them to the panelists individually or to the panel jointly.

Yes, sir.

QUESTION. I am an economist, and I really thank both speakers for a lucid and enlightening speech. And I'd like to ask a few—actually I'd like to make a comment on Peter's remarks. He mentioned that Korea resembles very much in its export strategy Japan, and I think this is, to some extent, true, and it may be one of the factors why Korea appears to be a second Japan.

Now, I'm not going to argue against this point. What I am going to call attention to is really what matters is the trade policy of Korea. That is, nobody really would have so much against Korea to wish Korea to fail. I guess it is okay, even from the United States point of view, for Korea to succeed in the United States market. What really matters is what's going to be Korea trade policy, whether it would resemble Japanese trade policy. What really bothers a lot of people seems to be the Japanese success in this market—but I think what really should bother them is the failure of Japan to expand its imports, especially expand its imports of manufactured goods from other countries, including the developing countries.

Now, in this regard would Korea in the future follow Japanese trade policy is I think the relevant question. And I think I'd like to recall Peter's remark earlier that Korea is a very small country, that is, its economic size is 5 percent of Japan's. So if Japan grows, say, 5 to 6 percent a year, then it will add the entire Korean economy to the Japanese economy in a year. That's how different the two economies are.

And I think it has a bearing on what the optimum trade policy is for a country. I'm not going to say that what the trade policy of a country actually takes is going to be very different; it could be indeed very similar to Japan at some point. And it was similar I think in the 1970's. But optimum trade policy for the country is very much dependent on the size of the country. That's my thesis.

Then Korea should not follow as protectionist a policy as Japan. And when it followed a rather protectionist policy in the 1970's, it paid very dearly in its fall of economic efficiency and eventual negative growth in the 1980's.

So I would submit that in this regard what the future trade policy of Korea is going to be—in this regard I think Korea would be very different from Japan, because its optimum trade policy, that is highly dependent on the size, is very different. So in the future Korea may take a trade policy that resembles the Japanese, but then, again, I think Korea will pay dearly economically, and then will revert back.

So this is something that we have to watch, but that's the addition that I would like to make to Peter's comment.

Mr. AHEARN. Peter, do you wish to respond?

Mr. PETRI. I agree—as a question from an economist to another economist.

Mr. AHEARN. Other questions? Yes, sir.

QUESTION. On localization, we've heard one speaker talk about import substitution policy and liberalization was mentioned also by another speaker in the context that, well, maybe localization has to do with diversifying away from imports from Japan. But what we are dealing with, particularly here in Washington, is a perception, which is a very dangerous perception, which is more important than the economic facts that we've been discussing, and that is that Korea is a second Japan, and that Korean protectionism is similar to Japanese protectionism.

And when you have a policy like localization, it's very easy to confuse that, and you have a situation where American firms now

are complaining about the localization policies and complaining to people in Congress that reinforce that.

So my question for the Korean panelists is: Is this a policy that is going to be pushed so strongly. I can see it perhaps in domestic political terms in Korea—look, we are not going to throw you to the wolves of foreign competition immediately, we are going to give you more protection. But, nonetheless, when that's played back here in Washington, that has a very difficult problematic sound to it. And I just wonder, is this something that's going to be phased out, or can you find a new vocabulary for it, or something?

Mr. AHEARN. Do you want to take a stab at that?

Mr. DUK-CHOONG KIM. Well, I disagree. John mentioned that we still have industrialization policy in the south. A couple of years ago the Minister of Commerce and Industry completely abandoned all those policies; we no longer have it. Therefore, even those localization policies, whatever it is, I never heard of those the past two years. It's up to the private enterprise; if they see that's fit, they do; if they are not competitive, they are not doing it.

So all those special policies they used to talk about, if you go back to the last year, whatever the new government enacted, it's none. For example, a good friend of mine is commerce minister, Dr. Ra [phonetic]. All those bureaucrats try to bring many measures to his desk; he says, look, what we should do is hands off, just don't bother business. That's his first reaction to all these bureaucrats. Since then he hasn't done anything. So these are the things.

The reason is, we know—no longer government can do. How government can direct this direction, this industry, so and so, such a short life cycle—it's a very difficult situation. Even though suppose that's the case, government really has no special means to direct such an action. Unless you have a financial means, you cannot even succeed, even though you have policies. Now, as I mentioned earlier, no longer has the government that capacity, because private industry is so huge.

QUESTION. I like your answer better than the answer that Minister Ra gave when I asked him the same question a couple of weeks ago.

Mr. DUK-CHOONG KIM. Thank you.

Mr. AHEARN. Are there other questions? Yes, sir.

QUESTION. Speaking as a Korean-American and as a political scientist, I'd like to ask my colleagues from Korea to comment on the following points. Your discussion of liberalizing the Korean market in terms of, let's say, capital versus trade, but, as a political economist, I heard of the service industry needing also to be opened in the Korean context. But just three or four months ago I happened to turn on the CNN report from Washington, D.C., and Dr. Park Jung-Choo [phonetic], who is KDI president, was commenting, and he said that the Koreans are ready to open their service industry if Americans are also ready to open its industry, let's say in the area of the construction business—not so much Korea getting all the banking industry opened up, you know, in terms of U.S. pressure.

So my question is: Is there any study among the Korean economists in Korea as to which sector of the service industry needs to be opened or not opened?

Mr. DUK-CHOONG KIM. Well, as you know, in Korea already 53 percent of our GNP is in the service area, so Korea is no longer so manufacturing-dominated, the economy. In regard to the opening of the service sectors, the government has a program set forward—even capital markets, for example, is on schedule and actually depends upon next year, and so on, now, much faster than anyone can perceive a few years back. So this is coming. Even insurance, for example; even retailing; there is full banking. So you can see in all these areas there is really opening that's going on. That's the position of our government.

Mr. AHEARN. Well, thank you very much. I promised everyone here that we would close at 12—we are only a few minutes after 12, so we have done very well. I would like to thank you all for coming, and I hope you've learned from this session. Particularly I'd like to thank the panelists for their presentations, and John Bennett for his remarks.

[Lunch recess.]

Mr. MORSE. I am going to introduce Dr. Kim Kihwan.

Dr. Kim, as I think most of you know, is chairman of the Board of The Ilhae Foundation, which is a private non-profit organization in Korea devoted to research on foreign and domestic policy issues, education of future leaders, and encouraging excellence in achievement in government, business and science.

It is also a foundation that has a very difficult mandate and a broad scope in some sense. He is trying to establish what would be the equivalent in the West of something along the lines of either the Wilson Center, where I work, or something along the lines of CSIS or other types of institutions, but it is also a memorial in some sense to the families and the children of the people that were killed in Rangoon during the bombing there, and so it has a very important emotional and psychological dimension to it in terms of Korea's elite leadership in the past.

So it is a very important institution in terms of the future of Korea, and I am sure some of the things he will say will relate to that.

Until 1986, he was in the government as Secretary-General of International Economic Policy. Before that he served as Vice Minister of Commerce and Industry, from 1983 to 1984. He was president of the Korea Development Institute from 1982 to 1983, and held a number of other positions, the Monetary Board, senior counsel to the Deputy Prime Minister, and so on. A very distinguished career that he built on from his earlier days when he got his Ph.D. degree in economics from the University of California at Berkeley—Bob Scalapino is here with us from Berkeley. He has an M.A. in history from Yale University, and a B.A. degree from Grinnell College in 1957.

And he has contributed to a number of books—I will just mention a couple: *Korean Economy: Past Performance, Current Reforms and Future Prospects.*

So it is a real pleasure to welcome you, Dr. Kim, and we appreciate your coming all the way from Korea just to share your thoughts with us.

## STATEMENT OF KIM KIHWAN, PRESIDENT, THE ILHAE INSTITUTE

Mr. KIM KIHWAN. Well, Ron, thank you very much for your very kind words of introduction. Those of you who know Korea enough know that there is a saying in Korea that even seeing the diamond on the mountain comes after a meal, but after the kind of meal we had today nothing should have come after the meal. [Laughter.]

Well, let me say that I am very pleased and honored to be invited to address such a distinguished audience today. As a resident of Seoul, it is not every day that I get the chance to speak to a powerful and learned Washingtonian audience on a topic of great mutual interest. Before I begin, I would like to thank the Wilson Center, not only for giving me this opportunity to speak but for holding this seminar as well. The dialogue here today, I am sure, will go far towards promoting greater understanding between our countries on a vital aspect of the Korea-United States partnership.

Let me begin by putting Korea-United States economic relations in historical perspective. The economic relationship between our two countries has undergone so much change over the last three decades that it is nearly unrecognizable from what it was at its inception some 30 years ago. The donor-recipient ties of the 1950's soon gave way to a full-fledged partnership, helped in large part by Korea's economic take-off in the Sixties.

In 1962, the total volume of trade between Korea and the United States was no more than $230 million. From 1962 to 1986, trade between Korea and the United States grew almost a hundredfold, with two-way trade amounting to over $20 billion in 1986. By far, the United States is now Korea's most important trading partner, buying some 38 percent of our nation's exports last year. For its part, Korea is the seventh largest trading partner of the United States, ahead of even France and Italy.

Korea and the United States also have growing investment ties. Since the early 1960's, American businesses have made almost $900 million in direct investment in Korea, making the United States the second largest single supplier of capital to Korea. Lately, the flow of investment has been running both ways. Korean investments in the United States at the end of 1986 totaled $212 million, which includes color TV plants in New Jersey and Alabama, research outfits in Silicon Valley, a steel processing operation in Pittsburgh, California, undertaken jointly with U.S. Steel, and coal mines in Pennsylvania and Alaska.

Given the tremendous rate of growth, it would be naive to expect our economic relationship to be free of problems. Indeed, there have been problems, and I think few people would argue with me when I suggest that it is the very speed of growth and change in our economic ties that has given rise to the recent trade frictions between Korea and the United States. Such rapid change requires adjustments—both psychological and real—on the part of both countries. However, almost invariably, the process of adjustment has lagged behind changing realities.

Let me give you an example or two of what I mean by this. The United States still perceives Korea as a country that is dragging its feet on market-opening, as Japan has done in the past. Yet since

the inauguration of the present government in 1980, Korea has been liberalizing its markets for the benefit of its trading partners as well as for its own economy. As a result, the import liberalization ratio, or the percentage of imports which require no prior import licensing, jumped from 68 percent in 1979 to 92 percent last year. By 1988, this ratio will reach 95 percent, a level comparable to that in developed countries. Furthermore, the average tariff rate on manufactured imports was lowered from 32 percent in 1980 to 19 percent this year, and will be further lowered to 17 percent by 1988.

In carrying out these reforms, Korea has paid special attention to items of interest to the United States. In fact, since the visit of President Reagan to Korea in 1983, Korea has liberalized some 167 items ahead of schedule at the request of the United States and intends to liberalize about 110 more items of particular interest to the United States over the course of this year and the next.

Liberalization has not been limited to trade alone. As a result of government efforts to liberalize Korea's direct foreign investment policies, less than 8 percent of Korea's manufacturing industries have yet to be open to foreign investment, and this ratio is expected to be drastically reduced by 1988. Furthermore, the government no longer has restrictions on the repatriation of principal and remittance of dividends, and it allows foreigners a 100 percent equity share in many industries.

Of course, Korea may not be moving as fast as the United States and other trading partners would like, but it has been moving as fast as it possibly can, given its economic and political constraints. In fact, few countries have made as much progress in opening its markets as Korea has, and fewer still have done so on their own initiative. The fact that Korea undertook to liberalize its trade policy on its own is even more impressive, given the considerable opposition to market-opening at home.

Despite this opposition, the government has held steadfast to its free trade commitment. It has honored its market-opening schedule with very few exceptions and continued to do its best to educate the general public about the advantages of a more open economy.

In short, in asking Korea to open up its markets when it has in fact been doing so on its own initiative, the United States is pushing a man who is already running as fast as he possibly can.

In defending Korea's market-opening record, I do not mean to suggest that no real trade problems exist between Korea and the United States. On the contrary, a number of tricky problems remain. The United States, for example, has pressed for market access for a number of particular items which Korea has found difficult to accommodate, such as beef and wine. It has also asked for entry into Korea's market for such services industries as insurance, freight forwarding, and advertising. In recent months, the United States has insisted that Korea revalue its currency in order to help correct its trade surplus with the United States, a measure which Korea has so far resisted by and large.

For its part, Korea has some complaints of its own. Three years ago, the United States slapped a stringent quota on Korean steel exports in spite of the fact that the Korean steel industry is one of the most competitive in the world and a fair trader to boot. Only

last year, the United States once again tightened its bilateral quotas on Korea's textiles and clothing exports.

More generally, Koreans have complained that the United States has been concentrating excessively on the need to improve market access for U.S. exports overseas as a means of reducing its trade deficit. In their view, this focus is misplaced. This is not to say that greater access is not needed; on the contrary, Koreans would be the first to admit that the U.S. market is far more open than most others, including the Korean market, and that the United States is justified in seeking freer and fairer trade worldwide.

Nevertheless, they have felt that the American preoccupation with market access has diverted attention from the basic cause of the overall U.S. trade deficit, namely, the huge Federal budget deficit. As far as the budget deficit is concerned, it is worth noting that even the current devaluation of the dollar will not do much good until and unless the budget deficit is reduced.

Furthermore, many Koreans have difficulty understanding why so many U.S. Congressmen are trying to pass trade legislation that will, among other things, impose an import surcharge against certain countries. This sort of approach would, of course, do great damage to the multilateral trading system.

Speaking for myself, the Trade, Employment, and Productivity Act of 1987 submitted by the Administration is worrisome enough. But if its bad cousins in the House and Senate should ever see the light of day, we should forget about achieving progress in the New Round of Trade Negotiations that has just gotten underway, after years of hard work on the part of those who want to see free trade strengthened.

These issues currently outstanding between Korea and the United States are, of course, important, and I would be lying to you if I told you that they will be easily resolved. In fact, I would say that they will not be easily resolved, especially if both countries try to deal with these issues the same way they tried in the past.

What was the typical way in the past? All too often the U.S. Government simply compiled an ad hoc list of items based on complaints from U.S. industry and presented it to the Korean government, presumably with the expectation that the Korean government would take action to open its market with little delay. Of course, concerned with the impact on the domestic economy, the Korean government was often not in a position to take immediate action. The failure to take immediate action then became a source of great unhappiness on the part of the United States, thus starting what might be called the trade friction cycle.

In order to do away with this sort of harmful friction cycle in the future, I would like to make one suggestion. Instead of presenting an immediate action list, a government should ask the other government to sit down together to work out a reasonable, preannounced market-opening schedule for the whole comprehensive list of items in which it has special interest. This schedule approach would, of course, have one great advantage in that the agreed-upon schedule would make it clear to everyone concerned as to where the governments want to go by way of liberalization in a few or several years' time and how much they should reasonably expect from each other.

Let me now go on to make two more suggestions.

It is in the interest of both Korea and the United States to reduce their huge trade deficits with Japan. For both countries, their trade deficit with Japan is the number one trade problem. For the United States, its trade deficit with Japan accounts for the biggest portion of its trade deficit by far and as such is the single largest source of protectionist pressures in the United States. For Korea, its chronic trade deficit with Japan limits its ability to reduce its trade surplus with the United States without endangering its debt-servicing capability.

Korea and the United States can work together toward their common goal of reducing their trade imbalance with Japan and at the same time reduce the trade imbalance with each other. Both Korea and the United States need to sell more to the Japanese and buy less from them. Korea needs to buy more from the United States, and the mirror-image of this, of course, is that the United States should try to sell more to Korea.

Fortunately for Korea and the United States, policies and external developments are going their way. For one thing, recent currency trends are favorable to restoring a balance to the three-way trade flows between Korea, the United States and Japan. With the rise in the value of the Japanese yen, U.S. consumers and businessmen are less willing to buy from Japan, and there are great incentives for Korean businessmen to shift their sourcing of imports away from Japan to countries such as the United States.

As a matter of fact, in order to take advantage of these developments, the Korean government recently launched an effort to diversify the sourcing of imports away from Japan, and a major beneficiary of this effort is expected to be the United States. In fact, all of you know that the Korean government sent a mission here only a couple of weeks ago to "Buy American." That mission spent almost $2 billion on U.S. products. Of the total purchase, it has been estimated that at least $400 million worth of goods represents a genuine shift of imports away from Japan in favor of the United States.

Still another great opportunity for Korea and the United States is in the area of investment. The United States is an attractive place for Korean investors, as Korea is for American investors. I am particularly pleased to note that over 30 percent of the $212 million that Koreans have invested in the United States was carried out in the last two years, and that almost half of the $900 million that Americans have invested in Korea were made in the last three years.

With the improvement in Korea's balance of payments, I am sure that Korea's investment in the United States will grow even more rapidly in the future. Prospects for U.S. investment in Korea are bright as well. The easing of Korea's foreign investment policies that I referred to earlier has greatly improved the investment climate in Korea. So has the strengthening of protection for intellectual property rights. Last year, the National Assembly passed new bills providing for greater protection of product patents, copyrights, and computer software, and when all supporting regulations are put in place, Korea will be providing a level of intellectual

property rights protection comparable to that found in many developed countries.

The greater inflow of U.S. investment and technology into Korea will go far toward restoring the balance of trade involving Korea, the United States, and Japan. for example, if U.S. firms produce more parts and components in Korea jointly with Korean firms, U.S. industry will export more capital goods and raw materials to Korea, sell more parts and components to Japan, and buy less of those parts and components from Japan.

In the long run, of course, greater U.S. investment will permit American firms to take advantage of the great opportunities associated with the new role that Korea is expected to perform in Northeast Asia. Korea is rapidly on its way to becoming a new hub of trade, industry, and finance in the Pacific Basin. In fact, we Koreans already see ourselves as the center of our universe—the East Asian universe. Situated smack between two economic giants, Korea is the ideal springboard aimed at the heart of the Japanese and Chinese markets.

As you all know, the Japanese market is the second largest market in the world. At long last, the Japanese are beginning to open their market, if somewhat reluctantly. The Chinese market is, of course, much smaller than Japan's. However, given China's population of over one billion and the 10 percent annual average growth rate that the Chinese economy has enjoyed since 1979, the vast potential of the Chinese market speaks for itself. If we can combine American technology and capital with Korean manufacturing prowess, there is no saying how far our partnership might go in these two markets, or for that matter, in the entire Pacific Basin region.

I would like to conclude by stressing a point that I made earlier only in passing. In order to realize all the opportunities for cooperation between Korea and the United States, the international trading system and economic environment must be improved. Toward this end, the two governments should work very closely to ensure the success of the New Round of Trade Negotiations. Without a successful outcome to the negotiations, the world will find itself in danger of going back to the dark days of the 1930's. I would, therefore, like to ask each and every one of you here today to work together not only to prevent such a reversal of history, but to realize the immense new opportunities on the horizon. [Applause.]

Mr. MORSE. We have just enough time to take one or two questions if anybody would like to ask something before we move to the next panel. Does anybody have a question, or anything broader? I am sure he can handle any question you have.

QUESTION. I was very interested in your suggestion for a new style of dialogue between the two governments, and, having participated in some of those old discussions where there were lists and so forth, the original concept of the United States-Korea consultations at the under secretary level was, in fact, to have a dialogue about the whole relationship.

How do you see this progressing? Will this be a possible suggestion for the future? Can that be moved on?

Mr. KIM KIHWAN. Yes. I think that the consultative mechanism ought to be continued, we should continue to utilize that mechanism. But what I am suggesting is that the way agenda be brought up in the forum—in the past, as I said in my prepared remarks, too often the issues always come up in a very ad hoc fashion. My experience has been that almost any new visitor or mission comes from the United States, a new list, and sometimes there may not be much consistency between different lists, and usually the expectation is that demands be met without much delay. But no government can take action in a short time. Things cannot be solved or settled in a minute, like instant coffee. And a sort of bad will gets created.

The most troublesome aspect of this process is that neither party knows where it is going and where it is going to end up, and—well, speaking about that problem from the Korean side, suppose you met a request put on a particular list. You aren't sure, you know, how long it will be before you are going to be presented another list which you have to present to the Korean public for action. So what I am suggesting is let us try to get a complete, comprehensive list and then try to work out a preannounced schedule of liberalizations for that entire list.

Some of the things that have been put forward to the Korean government could be met if you—you, meaning the United States—allow a little more decent time. But so often very tough trade problems are not brought up until the last minute. And I am making this suggestion in anticipation of the kind of problems that remain to be worked out between the two governments. Speaking very broadly, most of the manufactured goods have been liberalized, and what remains to be done is in the area of agriculture; and to work on agricultural problems, the government needs a great deal of time.

I just hope that some time, let us say in the next few months or next year, the U.S. government will come to Korea and open up the rice market, because you just cannot open up the rice market with one year's notice or two years' notice because you have to think a lot about converting those rice paddies into some other use.

So for this sort of problems which take a lot longer time, we need kind of sufficient advanced notice. So what I am suggesting is this sort of thing. The United States may present a comprehensive list, then say, well, we leave it up to you which you want to open first, but let us try to open these markets within the next five years or next seven years. Then sort of leave it to us to determine the priorities and which items are to be put at the front end and which items last. It would be much better, instead of saying that you insist that thirty items be opened, markets for that be opened next year.

Mr. MORSE. Another question? One more and that's it.

QUESTION. Let me ask a very specific question. When will it be possible for foreigners like myself or any nationality to directly buy stocks on the Korean stock exchange? Has a date been set?

Mr. KIM KIHWAN. Well, I am not in the Ministry of Finance.

QUESTION. He said you could answer any question.

Mr. MORSE. I said that.

Mr. KIM KIHWAN. I can, but not in the affirmative. Even in that problem, you know, I think instead of asking a question in that style, assuming you represent the government, say: Could you open your market within three years? If you say it that way, then the Korean side would be much more receptive—well, let's see. Is that the sort of thing that you do it by next year? Because we have, you know, congressional elections coming and so on, then not much can be done.

Mr. MORSE. Thank you very much, Dr. Kim.

Mr. KIM KIHWAN. Thank you.

Mr. MORSE. We will move right on.

## PANEL 2.—THE SOCIAL, POLITICAL, AND STRATEGIC CONTEXT OF THE KOREAN ECONOMY

PANELISTS:

Kyong-Dong Kim, Professor of Sociology, Seoul National University, Fellow, the Wilson Center.

Sung-Joo Han, Professor of Political Science, Korea University.

Daryl M. Plunk, Senior Policy Analyst, the Heritage Foundation.

MODERATOR: Larry Niksch, Specialist in Asian Affairs, Congressional Research Service, Library of Congress.

COMMENTATOR: Gregory Winn, Division Chief, Private Sector Programs, U.S. Information Agency

Mr. NIKSCH. Let's assemble Panel 2, please. [Pause.]

First, in terms of the schedule this afternoon, we will run Panel 2 until approximately 3:35. Then I would propose taking a 5-minute coffee break, kind of a stand-up break, get coffee and return to your seat. Then go directly into Panel 3.

I think also we ought to keep this informal. If you want to get up and get coffee during the two panels this afternoon, please feel free to do so.

So let us do it that way, and then, hopefully, we can finish roughly at 5:15 when we propose to finish.

Now we are going to talk about political and security issues in this panel. And I think it's important to remember that our relations with Korea involve more today than just trade and economic questions, that there are in United States policies some very serious problems in terms of security in the Korean peninsula and in northeast Asia, as well as serious political questions within South Korea itself that the United States Government is trying to deal with today.

When we look at northeast Asia and the northwest Pacific today, there are certain things about the security situation that seem to be relatively constant. It is an area where four major powers come together and where each of these powers has vital interests in this region and in the Korean peninsula. The Soviet Union, China, and Japan, of course, are located in the northeast Asian region geographically, so this will not change. And, of course, because of our role in the world today, we are also there with very important interests.

In the Korean peninsula itself, 34 years since the end of the Korean War—the peninsula remains divided with the two Korean states still very hostile toward one another. And I think if one looks at North Korea's rhetoric, its deeds, and its military capabili-

ties, anyone would have to come to the conclusion that South Korea today continues to face a very serious threat from across the Demilitarized Zone.

But certain things also have changed with regard to security, one of which is the stepped-up involvement in Korean affairs by the other major powers. This is a new development that we have begun to see unfold in the 1980's. It encompasses a more assertive Soviet policy, a Chinese policy toward Korea which has gone through some significant changes in the last five to ten years, and a Japanese role that, as we have already discussed, is very important economically but also politically and diplomatically is more assertive now than it was prior to this particular decade.

The Soviet Union, besides being more assertive in a general policy sense, continues its military buildup in this part of the world. That buildup now becomes a new factor in Korean security along with the military and political situation on the peninsula.

But perhaps today the most pressing problem for my government is within South Korea itself. Here we face a political situation which has become quite tense and which contains the possibilities for a worsening and perhaps more violent-prone situation in the future. We have the government of the Republic of Korea deadlocked with the political opposition in negotiations to revise the constitution; a deadlock which, in my view, at this juncture shows few signs of moving forward to some sort of negotiated settlement.

We also see very visible anti-Americanism in South Korea for the first time since the late 1940's, certainly on the college campuses. And I think we ask ourselves now: Will this spread beyond the college campuses in the future? What has caused it? And what can we as Americans do about it in the future?

We have I think a very distinguished panel to cover these and related issues involving security and political matters. Dr. Kim Kyong Dong is from South Korea. He was educated at Seoul National University, and he is presently at the Woodrow Wilson Center doing sabbatical work with Ron Morse's organization.

He is an expert in the social and cultural aspects of Korean politics and Korean political development, and he will talk about these and some of its ramifications with regard to the trade question this afternoon.

Professor Han Sung Joo is a professor of political science from Korea University, and he is currently at the Rockefeller Brothers Fund in New York and is also a visiting professor at Columbia University.

Professor Han is well-known to me, and I think to many others who are interested in these kinds of issues, as an authority on North Korea-South Korea relations as well as the role of the major powers in the general security situation in northeast Asia and the northwest Pacific.

Daryl Plunk is a specialist on northeast Asia, and especially Korea, with the Heritage Foundation. I have known Daryl for sometime. He has been very active in both speaking and writing on the security situation in and around Korea, as well as on the political situation currently inside of South Korea.

We have Dr. Gregory Winn from the United States Information Agency as one of our commentators. Greg does a lot of different

things at the USIA, but Greg is also a bona fide expert on Korea. He has spoken, he has written about it in the past. He has consulted with American firms concerning the political situation and political risk in Korea, and he is I think a very informed person to give us some commentary this afternoon.

Finally, Richard Bush from the House Foreign Affairs Committee was to have been our final commentator. I just learned about an hour ago that Richard cannot join us this afternoon. The House Foreign Affairs Committee is marking up foreign aid legislation and that mark-up session carried over longer than he expected into this afternoon. So at the end I may offer in his place a few comments of my own and, hopefully, in a small way will fill the role that I know he planned and looked very forward on playing today.

So without further ado, let us turn to Dr. Kim Kyong Dong as our first speaker.

**STATEMENT OF KYONG-DONG KIM, PROFESSOR OF SOCIOLOGY, SEOUL NATIONAL UNIVERSITY, AND FELLOW, THE WILSON CENTER**

Mr. KYONG-DONG KIM. Thank you, Dr. Niksch. I would like to express my gratitude to Dr. Ron Morse, of the Asia Program of the Wilson Center, for giving me this opportunity to take part in this very important forum. It is not very often that you will find a student of sociology participating in a conference dealing with economic issues like United States-Korea trade relations and issues related to that particular problem of management of that relationship. Now, for that I think the forward-looking insight of Ron Morse should be credited and for which I personally am very grateful.

To talk about social change as sort of a context for the dynamics of political-economic unfolding in a society like Korea is not a very easy task, especially in a 10 to 15 minute talk; I expected to cover so much ground. Let me try to focus on the dynamics of tension management and conflict resolution in the process of rapid change that Korean society is experiencing today.

Dynamism is, maybe, one of the terms that you can easily pick to characterize Korea, the Korean people and Korean society. Now this dynamism can be an asset in some sense, but a liability in another.

Looking at the current dynamics of change in Korea, we might want to ask these questions:

Is the socio-political instability that we are now observing to continue for long? And how long?

Is the continued instability to give an insurmountable blow and leave an incurable damage to the continued economic growth and prosperity, and societal development in general?

How then is the society going to manage tensions created by rapid industrialization and attending social change?

Or how is Korea going to resolve conflicts among different groupings? Especially, we are talking about emergence of competing groups, strata, sectors or interest clusters.

And how are we going to eventually establish some viable institutional mechanisms for stable conflict regulation, resolution and consensus building?

Now these, of course, are big orders, and of course I am not going to be able to provide any reasonable answers to all these questions. My job is to raise questions, I think. However, we shall look at some of the facts and background of these changes that we are experiencing today so that we have a better understanding of the emerging social forces competing for power in society and the prospect of reaching some viable dynamic equilibrium in the system.

I don't have to spend much time in describing the shape of change, at least on the surface. We have, of course, had some what we may characterize as unidirectional or unilinear, rather even changes, and some uneven changes. In this, of course, we have a mixture of the old and the new, something from the outside and indigenous—all sorts of mixtures, so we will talk about those.

But, first of all, we have been experiencing quite rapid industrialization and economic growth which is providing an impetus for other changes in the society. That change includes urbanization. Now, urbanization of the population has reached a point—now I think we have over six out of ten people living in places called cities, and recent figures tell us—this is the 1985 census—that four out of ten people live in the four largest metropolitan urban centers—Seoul, Pusan, Taegu, and (?).

Now, not only this population concentration in the urban areas, but also what is called the "urbanization" of rural people and the entire population, in fact, there is the cultural impact of the urban culture throughout the society. However, recently there has been some slowing down of rural urban migration with attending urban-to-rural return migration, which is still very small in magnitude, yet I think is a sign of some significant changes to come.

Now, on the micro level, because of this rapid process of industrialization attended by urbanization and, of course, introduction of cultures from the outside, I think we are experiencing generally a mobile society where the household is becoming smaller and the family type is becoming sort of the nuclear type in not only form but in composition and structure within the family—authority relationships, family roles, and so on—and this I think has great impact on other changes that are taking place in terms of human relations and organizational life.

Also attending this change in the family and household is sort of picking up on what we call modern-living-type of lifestyle, which is, I think, also pervading throughout the country including the rural areas.

And then further down in the microscopic area we are talking about the greater degree of individuation taking place; that is, greater independence and autonomy of individuals from the family and kinship and other traditional collectivities at least, and greater independence of and more opportunities for women because of this change.

But together with this type of individuation process we are also observing a greater amount of organization—organizational growth, that is—in number and in size and influence. This we call in our business a trend toward bureaucratization, with a steady in-

crease in the relative size of the pure employees in modern economic organizations, but there is some mixture here. Of course, the self-employed and family employed are generally decreasing, but then within the modern organized sector or together with that we also see some growth in something called the informal sector, and I will come back to that briefly.

Now, some uneven changes, of course, are occurring, although we know that there is this general trend towards an increase in white collar and blue collar plus sales service jobs in the occupational structure, and the new middle-class of salaried white collar people is also growing, together with the urban working class. With this, however, there is also a trend confounded by a continued growth of employment in this, what I call the urban informal sector. It is outside the modern large-scale organizations. People are self-employed, family employed, very active in entrepreneurial activities, and there are all kinds of theoretical explanations for that—but let's skip that.

And then with the growing middle-class and all that, still there is a fluctuating income distribution structure. However, the more sensitive side of this whole picture of uneven change is the perception, widespread I should say, that the wealth and power are unevenly concentrated in the sense that the rich get richer while the poor get poorer. So we have some kind of structural problems. That is a perception which is quite widespread, as I said—pervasive.

With the rapid growth in the economic sphere accompanied by relative material prosperity, the desire to improve the quality of life in the more nonmaterial, qualitative aspects of life is constantly being blocked or frustrated, so that there is this increasing desire on the part of people to improve their qualitative aspect of life, but then there are all kinds of inhibitions or hindrances that are causing frustration.

Symptoms on uneasiness and deprivation of need gratification appear in areas such as—let me just pick a few of those—an exploding increase in church or temple attendance. According to one statistic that I have been exposed to, in the past generation or so the size of congregations have jumped about 11 times. I don't know in which other countries you can see that sort of increase in the religious affiliation. And in one article about two or three years ago I contributed to one of the newspapers in Seoul, I mentioned this together with the significant increase in alcohol consumption, and some friends called me: you know, that was unfair. The juxtaposition was not very polite, I should say.

Also we are experiencing increase in the mental patients, divorces, and all kinds of violent and property-related crimes; and, of course, we are very familiar with continued student demonstrations. Now I think we may be making a record, already have made record in this sense: that we have been having student protests on campus for, consecutively, 27—now the 28th year. This is something.

Here, again, we will be back to the question of tension management and conflict resolution.

Now, what are some of the causes that create this kind of tension and conflict? Well, we can go into different explanations, but let me just pick out a couple of things. First of all, Dr. Kim earlier has

mentioned the rapidity at which we have experienced economic growth and other changes, and this sheer speed of change, I think, is creating all sorts of tensions. We now see, in the process of change, all kinds of lags between different sectors, gaps structurally, different aspects of society.

So when you have these lags and gaps among various parts of one culture and one society, there is bound to be tension created because you've got to adapt and adjust among parts experiencing lags and gaps.

Also the structural gaps, at least perceived structural gaps, are causing frustration for the people who are experiencing these gaps—they perceive that they experience these gaps. And there is also, when you have this kind of rapid change—a gap is going to be created between your rising aspirations and expectations, and what you are actually accomplishing or getting in reality.

Also this gap between what they think they have put in and therefore what they think they deserve in return, and what they actually are getting as reward—this kind of gap, a gap between their perceptions and their actual accomplishment.

These are some of the problems. And then, of course, we have had a very turbulent history of modernization in the past century or so. Throughout this period, as you all know, Korean society has been undergoing severe reshuffling and overturns, and so on. Therefore we also have experienced all kinds of twists and confusions in our value orientations. So, for instance, the legitimacy of the emerging elite, especially in the political and economic spheres, has been severely undermined from the foundation, because every time you have some kind of overturn or upheaval, there is a new elite, a new class emerging. People think that anybody can do it, but these people have done it in a not very desirable way.

So the sense that anybody capable and agile enough could grab the power or reach the top by any means available has come to pervade the values of the general populace. With this there is the growing tendency to see the whole society as a very egalitarian kind of system, at least in their belief.

So I have coined the term a "popularized elitism," that everybody thinks that he can be an elite—and he deserves to be an elite, but then there are all kinds of blockages and obstacles. So they get frustrated.

So we have this very strong egalitarian ethos with a keen sense of justice. If you think you are done wrong in some sense, then you are not going to stand by; you are going to do something about it.

Well, I have been talking about han, the feeling of resentment, grudge, that kind of emotional complex, while here at the Center in talking to other people. But this is a very strong emotion that Koreans have been brooding in their hearts.

So virtually everybody perceives and believes that he or she deserves more than what he or she gets, or feels the society is treating him or her unfairly. For somebody is fouling the rules of the game. This is a very serious problem of perception in our society.

Well, while certain things are easy to change, other things, such as some traditional elements and interest clusterings, are diehard, and they manage to affect the principle of social organization, human relations, distributive justice, and the rules of the game. So

we are now experiencing this mixture of the old and the new coming into the picture, and tensions and conflicts, potential conflicts, are there.

And, of course, open conflicts do not erupt easily with the exception of college students. I think the college student population has been sort of insulated, an elite kind of group that nobody touches—that's why this has become sort of a fashion. But open conflicts do not erupt easily mainly due to the successful suppression by the authorities. But we are also looking at a situation where once this kind of open conflict starts, then they can get very violent and extensive. Therefore, the authorities, perceiving this tendency, become more defensive, which leads to further suppression, causing the conflict to become more aggressive. A vicious circle thus is set in motion.

What are some of the emerging social forces? Well, as you all know, in the process of this whole complex of industrialization, urbanization, and the political changes, the military has gained great power and prestige, and military regimes have come into power. There is also talk about what is called the military culture in our society, that everybody thinks in the kinds of ways the military would usually.

But I think the military is being increasingly challenged to stay out of politics or return to professionalism, not only from the outside but also within the military itself.

The second group to be reckoned with, of course, is the bureaucracy. Now, the military and the bureaucracy tend to be the resisting force, that is, resisting change in the fundamental structure of the society. The bureaucracy, of course, has been very efficient in carrying out economic growth and all that with highly talented technocratic personnel, but it also has become a force of its own, resisting change and trying to maintain its power, despite the remark made by Professor Kim Duk Choong earlier that the private sector is growing in influence and that the government has very little resource to do anything about it. I think the bureaucracy would like to maintain that kind of influence. There is always, of course, challenge to this force from especially the intellectuals and the business sector.

So we have the third group—that is, the business sector. I think this group is very important, especially in the future, because it has strong managerial technocrats and has grown immensely in size and economic resources. So anybody who is going to run the government in the future is going to have to reckon with this new force.

But political power has not been accorded to it yet, commensurate with its economic prowess, and probably there is some increasing frustration among the business people.

Then, of course, we have the intellectuals, who are by nature noisy but have little power or influence.

Now, within the intellectual sector, of course, we have all kinds of diverse elements there, so we have a difficult situation here. There is a very delicate and ambivalent attitude toward the student radicals, especially among the intellectuals. That is going to be a problem that we have to solve in order to tackle this problem of the radicalization of the youth.

And labor is not often mentioned. And the reason why we don't mention it may lie somewhere else, not because it is not important, but it is such a volatile force. So far it has been dormant. But labor is also a diverse group within itself. It is more technically skilled, therefore an economically more prosperous work force versus a more disadvantaged work force.

And we often omit the people in the so-called informal sector, less organized sector.

The farmers—well, I don't have to say too much about this, but they are changing, too. They are becoming capitalistic in their economic outlook and very much individuated like any of their urban counterparts. They are not going to stay quiet for long.

And, finally, let me mention women. So far women have been so frustrated that their concentration has been on raising their children, often interfering with the affairs of educational institutions, so-called cheemaparam [phonetic], but sometimes they get involved in gambling and other anti-social activities. But with the high level of education attained by many in the female population, the potential for political action on the part of women is not to be lightly overlooked.

Okay, what are we going to see in the future? Well, I have just run out of my time, so I will be very brief in this. We have serious problems, formidable ones—but are these problems insurmountable? I don't know. I tend to be cautiously optimistic, like many people are. Maybe Daryl is going to talk about the political situation and the North and South and other international issues that are very important in determining the future of the Korean political situation. So just concentrating on these emerging social forces and their comparative edge in the days to come, I shall say that business is going to play a very important role, once determined to do so. Now, whether they are determined to do so, I don't know. Maybe we should ask Professor Kim Duk Choong again.

The intellectuals have been so frustrated, and they might, at some point, again try to influence the tide of change. However, here we have some limitations that we have experienced thus far.

Now, instability I think is going to stay with us for some while to come, and I think we have to live with it. But it is not going to reach a point where the society would collapse because of this instability. Why I believe that is because the Koreans have demonstrated a sufficient amount of resilience in weathering storms and surviving. And I believe we will make it this time, too.

Now, of course, the sad part of it is that we are learning it the hard way, by going all the way down to the pit and then realizing that it's too late, we've got to do something, crawl out of it. But somehow eventually we do manage to get out of it with bruises and shameful experience, with enough energy and wisdom to overcome that.

Thank you. [Applause.]

Mr. NIKSCH. Thank you, Dr. Kim. I think that was a very good starting point for this panel, talking about a society that has probably changed more rapidly than any society that I can think of in the history of the human being really, if you look at South Korea today. Your prepared statement will be inserted in the record.

[The prepared statement follows:]

PREPARED STATEMENT OF KYONG-DONG KIM, FELLOW, THE WILSON CENTER; PROFESSOR OF SOCIOLOGY, SEOUL NATIONAL UNIVERSITY

## SOCIAL CHANGE IN KOREA: THE DYNAMICS OF TENSION MANAGEMENT AND CONFLICT RESOLUTION

### I. INTRODUCTION

That Korea is a dynamic society and the Koreans, a dynamic people, pose a series of unique questions for the future, such as "Is the sociopolitical instability that has plagued the country so long to continue for while? Is the continued instability, if it does, to give an insurmountable blow, and leave an incurable damage, to the sustained economic growth and prosperity? How is the society managing tensions created by rapid industrialization and attending social change? How are the conflicts to be resolved among different groupings, strata, sectors, or interest clusterings, to eventually establish some viable institutional mechanisms for stable conflict regulation-resolution and consensus building?"

To shed some reasonable light to these quite challenging questions and other related issues, which happen to be crucial to the future of Korea but are very difficult to tackle, we should try to understand the nature of dynamics in terms of (1) the shape of change, (2) the sources of tension and conflict, (3) the emerging forces competing for power in society, and (4) the prospect for reaching some viable dynamic equilibrium in the system.

### II. THE SHAPE OF CHANGE

Taking a quick look at the major patterns of change attendant to or consequent upon industrialization and economic growth, the following summary picture may be suggested. One should note that there are relatively even, unidirectional changes and uneven, fluctuating transformations.

(1) Even-Unidirectional Changes:

a. Urbanization: The urban population has reached 62.4% as of 1984, with Seoul occupying 23.8% and the four largest metropolitan areas taking up 40.9% of the total population by the 1985 census figures. A trend has been detected at a very gradual pace that the overall rural-urban migration is slowing down and the so-called U-turn or urban-to-rural return migration is picking up very mildly. With the spread of education and mass communication, "cultural" urbanization of rural communities is taking place extensively.

b. Organizational Growth and Bureaucratization: Not only the number and size of formal organizations are growing, their influence in society and the "bureaucratization" of their principle of organization is increasing.

c. Household and Family in "Mobile Society": On the microlevel, a trend is evident that the typically small nuclear form of family with cojugal sharing of authority and family roles becomes prominent. By the spread of "Modern-living" type of life-style among the large middle-class population, and the ideology of feminism to an extent, the status and role of women have undergone some shift, with an impact on the kinship relations in the direction of greater part played by the female side kin groups.

d. Individuation: While the basic principle of organization in society is still authoritarian in nature, greater independence and autonomy of individuals from the family and kinship, and other collectivities, is attained. And the same is true for the female population in general.

(2) Uneven Changes

a. Occupational and Class Structure Formation: The general trend shows an increase in white-collar, blue-collar, and sale-service jobs, meaning that the new middle-class of salaried people is growing, together with the urban working class, while the rural farm occupations are decreasing. However, this trend is confounded by a continued growth of employment in the "urban informal sector," and the old middle-class of petti-bourgeoisie. Also, the income distribution structure has been fluctuating over the years, not always in pace with the growth in the economy.

b. Problem of Perceptions: The more sensitive side of the picture is the perception, quite widespread, that the wealth and power are concentrated, and the sense that the rich get richer while the poor get poorer.

c. Quality of Life: With the rapid growth in the economy accompanied by relative material prosperity for the majority of the populace, the desire to improve the quality of life in the non-material, sociopolitical, qualitative aspects is constantly being blocked or frustrated. Thus, symptoms of uneasiness and deprivation of need gratification appear in such areas of problems as an exploding increase in church-temple

attendance, alcohol consumption, mental illness, divorces, crimes of violent nature, student demonstrations getting wilder, and the like.

### III. SOURCES OF TENSION AND CONFLICT

One should try to understand the impact of rapid industrialization and economic growth as the major changes in themselves and as the central source of transformation in other areas and sectors of the society.

Above all, the sheer speed, the rapidity, at which these economic changes have occurred calls for attention. For the speed creates lags and gaps among various parts of culture and society, causing tensions of adaptation and adjustment among those parts experiencing lags, and producing frustration for the people who experience gaps between aspirations, expectations, perceived goals, or perceptions of reality, *and* the actual accomplishments or reality itself. They also feel gaps between what they think they have put in and hence what they think they deserve in return *and* what they actually get as rewards.

Looking back, the turbulent and frustrating history of almost one century Korea has inherited has left the society with a structure as reshuffled and overturned, and with value orientations as mixed up and twisted, that the legitimacy of the emerging elite, especially in the political and economic arena, has been undermined severely from the foundation. The sense that anybody capable and agile enough could grab the power or reach the top by any means, legitimate or not, has come to pervade the value of the general populace—I have even coined a term for the strong egalitarian ethos with a keen sense of justice, "popularized elitism."

The traditional status orientation, the unusually strong need to attain some status in society, which has provided an impetus to economic accomplishment, has also led many Koreans to feel frustrated by a sense of "status inconsistency" where different criteria for evaluating one's status do not match with each other.

Thus, virtually everybody perceives and believes that he/she deserves more than what he/she gets, that the society it treating him/her unfairly, that somebody is fouling up the rule of game in amassing undeservingly large amount of wealth or grabbing and wielding excessive power: in short, overconcentration of power and wealth perceived to have been taken illegitimately is resented.

Whereas certain things are easy to change, other things, such as some traditional elements and interest clusterings, die hard and mangage to continue to affect the principle of social organization, human relations, distributive justice, and the rule of game. Once you are in power or control great wealth, it is hard to change that position no matter under how much pressure you may be put. In fact, the more pressure is applied, one tends to resist it with the utmost effort and often effectiveness.

Now, the acute feeling of *han* (sounds *hahn*), a complex emotional cluster of grudge, resentment, regret, and the like, caused by such frustrations and relative deprivations, turn into an urge to revenge; potential for conflict is pervasive.

Open conflicts, however, do not erupt readily, with the notable exception to college campuses, mainly due to the suppression by the authorites of social control, but once started they tend to become violent and extensive. This tendency makes the authorities more defensive, which leads to further suppression, causing the conflict to become more aggressive, and the vicious circle is not broken.

### IV. EMERGING SOCIAL FORCES

Under the circumstances, the following social categories, groupings strata, or sectors, are emerging on the social horizon in Korea to compete for power, influence, and prestige in society.

(1) The Military which has gained power and prestige through the war experience and the military regimes come into power via coups is now increasingly being challenged to stay out of politics and return to professionalism. But so far, it seems to have met the challenge with an iron hand, little compromise. It is going to play a very significant role in the shaping of the future in Korea, for sure.

(2) The bureaucracy (of government sector), with its talented technical personnel, has played a central role in achieving rapid economic growth. This fact has boosted the prestige, influence, and pride of the bureaucracy, but it has also created a self-image that it can do anything with the people in the private sector. This apparently is creating resentment among the public and intellectuals (some suggest the military also resents it, and vice versa). The bureaucracy also has become inefficient because of the big brother mentality of the big government. Thus, the intellectuals and the private sector, especially the business, are pressuring the bureaucracy to yield some authority and resources to the voluntary sector, and to decentralize control, regulation, as well as routine administration tasks.

(3) The business sector, with its own entrepreneurial leadership and managerial technocrats, has grown immensely in size and economic power. Its political power, however, has not been accorded, commensurate with its economic prowess, causing increasing frustration and resentment. While the business pressures the bureaucracy to give up its authority in certain areas of economic decisions, and tries to assert itself in the social arena of influence, it has its own problem of public image, due to the history of irregular processes of growth, as the "greedy" grabbers.

(4) The intellectuals, mostly university faculty, journalists, religious leaders, and students, have had their share of influence and frustration. While a minority has enjoyed relative influence and status in the government and vis-a-vis business, their relative influence has been less than meet the eyes and the majority has been on the other side, largely grumbling about the repressed opportunities to speak out and to be heard. Their resentment has been directed to the military for its political involvement, the bureaucracy for its powerwielding authoritarian meddling and inefficiency, and the business for its seeming lack of "social responsibility." But the intellectuals have their own problems and difficulties of being independent-minded and hard to agree on any issue, being discreet and hard to organize, and being diverse in their own characteristics, and especially their delicately ambivalent attitude towards radical students.

(5) The labor that has grown tremendously in magnitude has largely been dormant thus far. The more technically better prepared enjoy relatively higher living standards, and hence reluctant to create instability, while the less well-off majority, pressured by both the government and the management, take a wait-and-see posture, still unsatisfied with the status quo yet afraid to disturb the equilibrium. At least, the labor thus far has resisted the call for engagement waged by the student radicals, but the situation is volatile and uncertainty looms as to how long they could be silenced.

(6) The farmers have been a relatively quiet force as far as open conflicts are concerned, but this does not necessarily reflect their lack of disaffection and frustration with their own share of suffering and blocked aspirations. In the face of rapidly industrializing society with the constantly shrinking farming sector, the farm population has largely been a neglected species, regardless of the occasional, election-year, pitch on the part of government to do something for them temporarily. In the process of modernization, however, the farmers have also become politically "enlightened" in their own way, "capitalistic" in their economic affairs, and "individuated" like their urban counterparts in social life. With some uneven development within the rural sector, rural poor class is the most volatile group that needs reckoning, economically and politically, not that they represent any significant power threatening the establishment, but that they are the sensitive part of the wound of the society in drastic change.

(7) The women, like they say, occupy the half of the population and yet few still tend to see women as a potential source of power and conflict in a traditionally strong male-centered society like Korea. Nonetheless, the status and role of women in the family, community, and society at large, have been undergoing transformation, in much more drastic scope then usually conceived. Due to their frustrated career and other social opportunities outside the family, women have thus far concentrated on their children or other private interpersonal affairs. This in itself has resulted in problems of overprotected and spoiled children, unhealthy zeal for educational achievement, or various anti-social activities on the part of women. The women's share of *han* still awaits to be released and tended to. With the high level of education among the female population, the potential for political action on the part of them is not to be lightly overlooked.

## V. PROSPECT FOR DYNAMIC EQUILIBRIUM

Major problems related to creating some viable dynamic equilibrium in Korean society so far may have to do with: (1) concentration of power in separate sectors, not shared with others; (2) lack of mechanisms to allow autonomy of each major institution in different sectors, and to coordinate diverse interests and norms of these institutions; (3) failure to allow the voluntary sector to form intermediate interest articulating groupings and organizations to represent the increasingly diverse, plural interests and demands, as well as to organize diverse power bases for more legitimate, viable political institutions; (4) maintenance of centralized political and administrative appartus and procedures for local affairs, thus leaving local communities virtually powerless and resentful of being at the mercy of some hand up there; (5) unnecessary suppression of more open expression of opinions and open dialog among different groupings; (6) slow pace at which the government tackles the

problem of social inequity and provides social security and welfare for the needy; (7) extravagent life-style of the nouveaux-riches, causing unnecessary feeling of resentment and alienation among the relatively deprived; and (8) unrealistic perceptions of international and domestic reality on the part of the radical youth, and the failure of the government to allow the intellectuals to have meaningful dialog with them.

The problems appear formidable, but not insurmountable, hopefully, if we can do the following: *first*, some hard look at the problems and soulsearching is required before any action to ameliorate the situation is to be taken; *second*, in order to do that, serious dialog among the concerned members of the leading institutional sectors and groupings is a must; *third*, the decision on the part of those with power to make decisions to yield some of that power for the sake of general societal development is crucial; *fourth*, sharing of power and resources between the non-voluntary (politico-economic) and voluntary sectors is definitely required; *fifth*, all these call for some sort of "moral" refurbishment on the part of the societal elite in all the sectors, strata, and groupings.

The prospect for these to come about in near future is not necessarily bleak, provided that every sector is willing to listen to others. Are they willing? I believe so. Only that not many have really tried hard to talk. I mean really hard, with a genuine sense of commitment, without any involvement of narrow self-interest.

The instability is going to stay with us in Korea for some time to come; we have to live it, I suppose. Yet, it is not going to reach a point where the society would have to collapse. Koreans have demonstrated sufficient amount of resilience in weathering storms and surviving, and I believe we will make it this time, too. The sad part of it is that we are learning it the hard way, by going through all the mud down all the way to the pit and then suddenly realize that we have got to crawl out of it, somehow. Eventually, we do manage to get out of it, with bruises and shame, with enough energy and wisdom to overcome them, though.

Mr. NIKSCH. Our next speaker will be Dr. Han.

## STATEMENT OF SUNG-JOO HAN, PROFESSOR OF POLITICAL SCIENCE, KOREA UNIVERSITY

Mr. SUNG-JOO HAN. Thank you. I thought I was going to speak last, and I was going to relate a story of my experience this morning, assuming that Dr. Plunk would have said everything that I would have wanted to say. But I will relate that story anyway.

I was coming here in the morning in a very bad rain. The Wilson Center put me up at a hotel, very comfortable, but a little too far away—16th Street and around P Street—and I couldn't get a taxi. It was very windy. And then there was a nice-looking woman also waiting for a taxi. She had called for a taxi, which would not come. So I ventured out—I borrowed her umbrella—and hailed a taxi, actually waited for about 20 minutes—all the taxis just went by. Finally, one taxi stopped and we got in. It turned out that the woman who was in the taxi already was a sociologist from Florida; she was on her way to USIA—what for I don't know. The lady who got in the taxi with me was a doctor from Atlanta; she was on her way to the Hubert Humphrey Building—I think it's called Health and Human Services. And, of course, I was coming here.

And the driver happened to be an Iranian. And the first lady asked me—well, told me, actually, without asking me—she said: It's too bad you are here now, the cherry blossoms are all falling because of the rain, and Mr. Reagan just announced a retaliation measure against you. [Laughter.]

Normally I don't argue when somebody takes me as Japanese, but this time, I thought, I didn't know what was to come next, so I said, well, it so happens that I am a Korean, not Japanese. And then we came to our respective destinations. We arrived at the Hubert Humphrey Building first, and the lady doctor, who was

quite young actually, she was getting off; her fare was, I think, $3.80 or so—make it $3.10. She took out a $10 bill and asked for change of $6. And then she hesitated a little bit and she told me I don't know how to thank you for getting the taxi for me, why don't you keep this? And, of course, I refused. And she was embarrassed. She gave it to the Iranian driver, who was very happy, $6. [Laughter.]

That made me think all morning and afternoon of some questions. I don't know what the moral of the story is, but would she have done what she did—she was a very well-intentioned person—would she have done what she did if I was not a university professor? Would she have done the same thing if I had been a Japanese instead of a Korean? Would she have done the same thing if she had come from Washington, D.C., or New York, instead of Atlanta? [Laughter.]

Or would she have done the same thing five or six years from now when foreign claims on the United States would be probably more than $1 trillion? That is, U.S. foreign debt would be that much.

But this is an actual story and a case of perceptions and misperceptions. I thought it was interesting.

I think my task is to talk about the strategic and international environment of Korea, and how it affected Korea's economic policies and economic performance, and in return how Korean economic policies and record would affect Korea's strategic and military situation. Of course, this is a very large and broad topic, and I don't claim to know what the answer is; I can just speculate. I can't really talk about all aspects of this I can think of. I will just focus on a few issues.

There have been studies as to the reasons why South Korea has been so successful in its economic development effort, and I think most of these studies will in fact point to South Korea's security situation, even though there are other countries which did not have those security or strategic needs which also accomplished rapid economic development. In the case of Korea, I think the security imperatives did have some bearing, particularly on the kind of policies that have been followed and the emphasis on large companies, the big guys, the champions, the conglomerates, for example, or the kind of organizational principles, disciplines, in Korean society, which is pretty much militarized in mentality. All these things have helped to achieve economic development, and, at the same time, resulted in certain economic policies which I think are coming home to roost, that are giving certain political difficulties.

And the kind of policies which might be attributable to the security needs and opportunities that the security situation offered to Korea was best exemplified by the so-called "big push" policy, or the emphasis on heavy and petrochemical industries that Dr. Kim Duk Choong this morning mentioned. And he did not want to elaborate on the other reasons why this particular policy was pursued. I would think that at least one of the reasons was the South Korean emphasis on military needs and military thinking, which would in fact emphasize heavy and chemical industries.

Having done that, as a result of a number of factors and circumstances, at the end of the 1970's there were difficulties, both politi-

cal and economic. There was high inflation; also there was growing radicalization of opposition which has become even more radicalized today, but at the end of the 1970's already there was a great deal of attack on these big guys, and government-business collusion, and so on.

The rate of growth was very low at that time, and also in some ways politicization of economic policies, which was expressed or demonstrated, and continuing mercantilism of the government and, in some ways, greater resistance to opening up the Korean economy to the outside world.

When the Chun government came to power in 1980 and 1981 it had to deal with many of these issues, and it did deal with these issues. Economic advisers, such as Dr. Kim Kihwan, who spoke earlier, I think had the foresight and wisdom and even the courage to pursue this two-pronged policy of stabilization and liberalization.

Now, I'm not an economist, but this was I think a wise policy, which did work. The inflationary rate went down and liberalization proceeded; economic growth was to be achieved later. And, from the economic point of view, I think for the most part it was an almost fantastically successful policy.

But politically speaking it was a set of policies that would make the government very unpopular. There are many reasons why the present government is less than the most popular government in the world or in Korean history, but at least some of the economic policies I think are responsible for that. It phased out farm subsidies; it made preferential credit for the big businesses or other businesses difficult; it did in fact suppress wage increases, which required dealing with labor in a very unpopular way; and at the same time it had to liberalize the economy both in terms of domestic economic measures and vis-a-vis the outside world—which, of course, was not very popular. And I will mention some of the forces that are opposed to liberalization in general, but particularly international liberalization.

Now, having said that, I just want to mention the implications of these economic policies and economic developments, rather than development as such, for the security situation. Obviously, the fact that South Korea is doing well economically would have a positive effect on its security and strategic situation. But these are for the most part long-term situations rather than short-term benefits. I think in the long run, as South Korea becomes economically prosperous, South Korea will become, already has become, quite confident vis-a-vis North Korea, for example. North Korea will feel much more anxious, will want to emulate South Korea, and then have to deal with South Korea, at the same time open up its own society.

But in the short run I think South Korea has been tempted to—if not, it should have been tempted to wait out, because time is on South Korea's side. North Korea, by the same token, would be much more defensive. North Korea does not want to have its own people or the outside world to see the great contrast between North and South Korea. At the moment, North Korea will have to let people see that at a certain point before the gap becomes even greater.

It creates a greater U.S. economic stake in Korea; it also enables South Korea to establish contact, establish an increased contact with such countries as China, the Soviet Union—already South Korean trade with China, mainland China, is substantial; it has been over $1 billion during the past two years in a row.

It will ultimately also help political development. It will make people more sophisticated; it will make people have a greater stake in the status quo, certainly in social and political stability.

It also helps to strengthen the South Korean military by making more funds available, making more technology available, and therefore again the security situation is likely to improve.

On the other hand, there is the minus side, at least in the short run, and I will just mention some of these things before I sit down. First there is the question of political stability. Today I think the greatest threat to South Korean security comes not from external sources but from internal sources; that is, as internal politics becomes more and more unstable, it will become very difficult to maintain U.S. troops in Korea, it will be very difficult to maintain strong armed forces. If we have other uprisings or sets of uprisings in the future of the like that we saw in the 1980's, I think South Korea will be very difficult to defend, no matter how many troops or weapons you have there.

Now, there is a little bit of fundamental question. That is, economic development, does it contribute to political stability or does it not? Does it contribute to democratization or not? At least during the past few years, five to ten years, we have seen countries in South America, in the Iberian peninsula, which have become democratized, even the Philippines. But in most of these countries it seems that economic difficulties rather than prosperity contributed to democratization. In the case of South Korea, the prosperity has in fact helped a rather authoritarian government to not only stay in power but perhaps in a constitutional way stay in power.

What I think is happening is that economic success would tend to postpone the confrontation in a way. I can't think of a good analogy, but it may be something like a person having pneumonia, and if he is exposed in cold, dilapidated housing, then people will know that he has to be hospitalized; but when the house is warm, the environment is quite all right, they probably will continue to apply aspirins rather than stronger drugs.

And therefore I think we have seen during the past few years, with the economic success, the possibility of greater confrontation or a larger confrontation growing.

A second problem I see is the trade friction or economic friction with other countries spilling over into political and security relations. In the case of Korea I think this will come perhaps—I'm not saying this as a probability, but as a possibility—via United States trade friction with Japan which will sour United States security relations with Japan, which in turn will weaken the South Korean security situation.

But even in Korea I think there is a great deal of resistance to the kind of pressure that is coming from abroad, particularly the United States. Just as a perfectly hypothetical case, if somebody graduated from Grinnell University and Yale University and got his Ph.D. from the University of California at Berkeley, and he is

in the government as the chief trade negotiator, he wants to be reasonable to his U.S. counterpart, he wants to do what is best for his country or for the economy. And then what kind of resistance is he going to get? He is going to get at home, from the radical left, who will vilify the government for giving in to foreign pressure—they see collusion between a fascist government and imperialistic foreign governments and countries, such as the United States and Japan. He will find resistance from the bureaucrats who will oppose him because they are generally against liberalization, but they are also against trade liberalization as well. He is probably likely to be opposed by the business sector—and I think there is business and there is business—I would certainly agree with Dr. Kim Duk Choong who said this morning that big business is not opposed to liberalization, but even among the big businesses and the lesser businesses, I think there is a great deal of protectionist sentiment.

There is also resistance from those in power who feel that they don't want to appear to be succumbing to dealing with foreign governments, and particularly making concessions, presumably for political reasons. Whether they do or not, very often, in the case of Korea, U.S. economic pressure is often seen as a political gesture on the part of the United States to put pressure on the South Korean government or to make the South Korean government position difficult. And, of course, the regime, those in power, in that kind of situation, would not want to be seen in that light.

Furthermore, he—this particular person—will not be getting any help from the intellectual community, those in the intellectual community, who, either for very rational, logical reasons or for emotional reasons, or for cowardly reasons, would not want to come to his defense. They would not want to be seen as somebody who will open up the country in the interests supposedly of foreigners.

For all these reasons, I think the trade friction is not likely to abate, even though I guess concessions will continue to be made, and particularly governments, which will try to be very popular, will find it very difficult to comply.

I can see a scenario, perhaps a worst-case scenario, in which this kind of friction, this kind of measures and countermeasures will escalate, and perhaps in Japan the Japanese politicians will see Mr. Nakasone's supposedly pro-U.S. liberal policies not working, and therefore some of the more rightist, more conservative, even some of the ultra-rightist politicians prevailing, in which case I think there will be even stronger measures by the United States, which ultimately may result in some kind of security consequence which cannot help South Korea.

I don't think this will happen, but certainly this is not something that is impossible to happen.

I'll stop here.

Mr. NIKSCH. Thank you, Dr. Han. Before I turn to Daryl Plunk, let me ask you: Are there any journalists present in the audience?

[One hand goes up.]

You are not supposed to be here.

VOICE. I am here as a member of the Asia Society.

Mr. NIKSCH. You are here as a member of the Asia Society. Well, okay, but let me remind everyone of the ground rules that Dr. Heginbotham spoke of this morning, that this meeting is not for attribution; it is off the record until the proceedings are published. And I would certainly ask you to abide by that ground rule.

So, without further ado, let me turn to Daryl Plunk from the Heritage Foundation, who is going to talk further about the political situation and also the international situation.

Daryl.

## STATEMENT OF DARYL M. PLUNK, SENIOR POLICY ANALYST, THE HERITAGE FOUNDATION

Mr. PLUNK. Thank you very much, Larry, it's a pleasure to be here. I'd like to thank you and Ron for inviting me to participate in this very interesting program and very distinguished panel. It's quite an honor to be here with Dr. Kim and Dr. Han, it was very nice of you to come all the way from Tokyo to be with us today. [Laughter.]

I'm sorry—Seoul.

The main focus of my presentation will be a nuts-and-bolts analysis of ROK domestic politics, as I see them. We've heard a good analysis of sociological trends in Korea and some general economic, political, and security aspects. I will try to concentrate on the nitty-gritty politics, the role of American foreign policy, as I see it, and a few of my thoughts about the future of politics in Korea.

I would like to begin by presenting a few observations on the impact of the United States-Korean trade dispute on the Korean domestic political scene. Several people have referred to this today.

Generally, South Korean public reaction to Washington's pressure for wider access to Korean markets, together with restrictions on certain South Korean exports to the United States, has been a very emotional and nationalistic. Many Koreans charge that Americans fail to take into account the vulnerability of the Korean economy. They also feel that Korea is becoming a scapegoat that the Americans would like to use to vent their frustrations over trade frictions with Japan. This is something we've heard several times today, too.

South Koreans also often say that the United States, after generously supporting the Koreans in the 1950's and 1960's, now ironically is punishing Korea for its success.

These frustrations have worked to fuel, among other things, the rise of a new phenomenon in Korea, and that is anti-American sentiment.

Another significant and sensitive aspect of U.S.-ROK trade disputes relates to South Korea's tense domestic political scene and the constitutional revision stand-off. U.S. trade pressures and resulting ROK concessions have generally been used as political ammunition for the government's critics. Given that national elections are scheduled for late this year, the Chun government is likely to become more cautious, I think, in its approach to further liberalization, at least in 1987. As in the United States, trade and economic policies are hot topics of debate in South Korea, especially during

an election season. That's something I think Dr. Kim Kihwan could have given us a lot of insight on.

Escalating political tensions in South Korea today have focused considerable American attention on the situation there, and on the state of our economic, political, and strategic relations with South Korea. The challenge for our government is to translate South Korean political realities into effective U.S. policies which serve the interests of both countries.

From an American point of view, if Korean domestic political tensions continue unchecked, there is a possibility that vital U.S. economic and security issues will be threatened.

No one doubts that the formulation of U.S. policy toward South Korea warrants serious consideration. But there are often formidable obstacles to the effective formulation of that policy; in particular, I think U.S. perceptions of South Korea are often characterized by widespread misconceptions. Physical distance and ethnic contrasts complicate our attempts to understand our faraway ally, and, as Dr. Han showed with his story, it works the other way around, too. There are often misconceptions in Korea about the United States. I'll have to try to one-up you regarding your story, Dr. Han. When I was in Korea as a Peace Corps volunteer a few years ago, I taught at a girls' middle school, a nice place in a small country town. My principal was a wonderful man, but, unfortunately, he was quite a heavy drinker. It goes back to what we were discussing earlier: maybe the pressure of society was too strong for him. Well, one day Principal Kim at about 11 in the morning showed up at school quite inebriated, and proceeded to make a spectacle of himself in front of literally hundreds of young middle school girls—they all came into the courtyard and saw him stumbling around. He had to be wrestled down by some teachers and taken to a little house behind the school. I returned to my desk in the teachers room, feeling rather devastated since Principal Kim was a friend of mine. I turned to a fellow teacher and asked, "Well, what's going to happen to Principal Kim now?" The teacher replied, "well, what do you mean?" I said, "When the parents and the school board finds out about this, what's going to happen to him? Isn't he going to be into trouble?" My colleague reponded "No, of course not. He's the principal. He can do anything he wants to do."

So that taught me a little bit about the Confucian mentality in Korea, certainly a different mentality from the United States. I thought I might as well teach my co-worker a thing or two about my culture, and I said, "Well, in the United States, if this kind of thing happens, the principal is likely to get fired." The teacher looked surprised, even shocked and said, "Fired? You mean assassinated?" [Laughter.]

So we have the misconceptions on both sides.

In examining the current South Korean political scene, viewing that situation through an American lens can present problems, I think. To understand Korea's political situation today it's useful to have an overview of where South Koreans are coming from. I won't go into a long description of Korea's modern history—I think most of you are already familiar with it. In a nutshell, the Republic of Korea was born out of chaos. The surrender of Japan in August

1945 ended thirty-five years of harsh colonial rule in Korea, and then Koreans were faced with the tragic partition of their country and the challenge of self-rule. Syngman Rhee was elected president in 1948 under a democratic constitution, but by the mid-1950's he was growing increasingly authoritarian. He was overthrown by a student revolution in 1960 after the rigged election of that year. Later came the ouster of Chang Myon in 1961, assassination of Park Chung Hee in 1979, and the turbulent rise to power of the current president, Chun Doo Hwan in the early 1980's.

So while some do call today, for a restoration of democracy in Korea, the fact is that Koreans have experienced precious little democracy. The ROK's history is dominated by authoritarianism and the politics of confrontation. That's what they are dealing with today.

Korea's have made some progress, I would say, in political development, but they have a long way to go. For example, as we all know, Korea has never experienced a peaceful transfer of power. The single term presidency is a fundamental clause in the current constitution which President Chun says he will abide by. If he does, this will be an important step for Korea.

There has been general political liberalization that we can point to. For all of the problems, there has been some lifting of political restrictions. I think the New Korea Democratic Party (NKDP), led by the two Kims, is a case in point. It became the most outspoken and strongest opposition party in early 1985 precisely because the government had begun to lift some restrictions on political activity.

As we know, the next election is scheduled for late this year and a transfer of power set for next year. South Korean political leaders are currently involved in a debate over constitutional revision. There is a stand-off at this point with the opposition party supporting a direct election, presidential system, and the government supporting a parliamentary cabinet form of government. Until early 1986 the government refused to even consider constitutional revision. In a very effective display of political mobilization, the opposition organized political support in favor of constitutional change, and President Chun gave in on that issue a year ago. The key point here is that the Chun administration has shown at least a willingness to respond to public pressure, which is a characteristic that is not particularly common in Korea's modern political history.

The opposition NKDP understandably proclaims unity around its agenda, but the reality is that the party is plagued by some significant factional problems, particularly due to the rivalry of the two Kims. And there are other factions which are promoting different ideas and political strategies.

I would make the case that the direct presidential election position is a rallying point around which they could all agree. It is not necessarily what they all agree with, and that is the problem they face today. Still, using any yardstick, they have been amazingly successful in their political offensive. In the face of strong popular pressure, the government was forced to respond in several major instances.

But, as this clash dragged on, many Koreans as well as foreign observers began to suspect that these opposed positions had less to do with democracy than they do with power politics, with the oppo-

sition leaders supporting a direct election system because they feel they can win in that kind of election, and with the government leaders supporting a parliamentary system because they feel they could survive in that kind of environment and dominate a government, or at least play a strong role in a coalition government.

Again, we all know that the opposition party is having factional problems these days. In particular, the domination of the two Kims has become a visible issue, and maverick members of the opposition party are speaking out against control of the old guard, meaning those two Kims. The young Turks also complain that the old guard control of the party is preventing younger generations from rising to higher echelons of the party. There is a question of democratization of the NKDP—that is the way that some of these maverick members have put it to me.

The Chun administration, for all of its successes—and I think we are familiar with those successes—is not without its problems either, particularly the government party itself. We know that Chun has pledged to step down—that's commendable. However, like the opposition party, the government party has deep-rooted institutional problems. For instance, President Chun, from the outset of his administration, said that he wanted to revamp the political party system in Korea and make it responsive to the people, saying that Korean parties have always been dominated by individuals. But five years later, I would say that the DJP is faced with this very dilemma. President Chun, rather than the party hierarchy, makes all major policy and strategy decisions.

So, ironically, except for the vocal factional feuding that's going on within the opposition party, the leadership and the decision-making characteristics of the NKDP and the DJP are in many ways mirror images of each other. This nearly absolute domination of the two opposing parties by a handful of party bosses has contributed to mutual distrust over respective ambitions, and hard-line positions taken by one side are tending to feed on the other. The result has been a stand-off.

Last year some Americans were so inspired by the fall of Ferdinand Marcos in the Philippines that they set their sights on Korea. But Korea is not a mismanaged nation teetering on the edge of revolution. There has already been a lot of talk about this, but I think the differences are much more significant than the similarities in that analogy. U.S. policymakers have accepted this, and there is a bipartisan consensus in the U.S. government that the current clash over constitutional revision should be worked out by Koreans—they are sophisticated enough to do it, and they are making some progress toward that end. Any direct U.S. involvement might jeopardize a peaceful resolution, because both sides might harden their position in expectation of U.S. support.

So while various U.S. government officials, media representatives academics and opinion-makers might disagree on the merits of what each side is saying in South Korea, most realize that a simple democracy-versus-dictatorship analogy or analysis is inadequate.

Now, I'd like to wrap up with just a few thoughts about U.S. policy options. I think the United States should continue the general policies it has been following with a few adaptations designed to conform to the changing debate. First of all, we should encourage

both sides to search for new avenues of possible breakthrough. The debate has stagnated.

Lee Min Woo, the opposition party president, came up with some new, innovative ideas a few months ago, and that was commendable. The DJP, for its part, should try some new ideas, too. The government party has been talking a lot about dialogue and compromise, but it has not been coming up with many new suggestions although over the weekend there were some developments that I haven't been able to catch up on.

We should continue to praise President Chun for his pledge to step down—it's a very important precedent that he will set. We should stress the importance of a Korean leader serving his appointed term and then voluntarily leaving the political center stage. Similarly I would hope to see our government caution ROK politicians to subordinate their own personal ambitions to the long-term interests of the Korean people.

Finally, the United States should emphasize the importance of the next government's legitimacy. Whatever political agreement might be achieved it is not going to be supported by 100 percent of the National Assembly members. I think no democracy can hope for that. But I hope that any arrangement which emerges will have at least minimal popular support, and hopefully a lot more than that.

Koreans are a very homogeneous people whose culture spans two millenia of recorded history. Today the Koreans remain remarkably resilient, understandably proud of all their accomplishments, and decidedly optimistic, about their future.

I think all of us would agree that during the last four decades Korea has made stunning progress in many fields. However, the realm of domestic politics remains an unfinished chapter.

But, however haltingly, the Koreans are moving in the right direction. They also remain cognizant of the magnitude of what's at stake. I think even opposition leaders concede these days that the majority of the Korean people are not ready to take to the streets and jeopardize their rising standard of living over the course of ongoing democratization. Nevertheless, Korean politicians are under increasing pressure particularly from the nation's swelling middle class, to reach an acceptable agreement and maintain social order. The Korean people, headed by this potent middle class, are clearly beginning to set the political agenda. Thus, I think there are reasons to be optimistic that all of these desires for political liberalization will eventually be fulfilled in an amicable way.

Thank you very much.

Mr. NIKSCH. Thank you, Daryl. Our time is running short. I am going to ask Greg Winn to give us some comments for seven or eight minutes, and then we are going to take about ten minutes for questions, because I do want some questions and discussions. We will then take a very short break, and then proceed to the next panel.

So let's hear from Greg Winn.

Dr. WINN. Well, I would like to thank the Woodrow Wilson Center and CRS for allowing me to participate. It's a most interesting and informative series of panels.

Since we are talking about economics, of course, it's important to realize that there is a major difference in North and South Korean economics, and I'd like to talk a little bit about North Korea. As you know, in the strategic context, North Korea's economic situation is very poor. Dr. Kim also discussed the social and intellectual problems in both Koreas. However, you may not be aware that there has been a very detailed study about the after-life in Korea, and that, indeed, there is even research on heaven and hell. For example, I read that a Korean official who made a great deal of money under the Park regime, perhaps illegally, died recently and went to hell. Upon his arrival he saw a wizened old man in the corner, and he went up to him and he said "Where am I?" And the fellow replied "Well, you are in South Korean hell."

"Oh, my God," the new arrival cried. "Well, tell me, what is my punishment?" "Well, there are three punishments." "Three, What are they?" "They boil you in oil, then the Devil sticks hot irons in you, then they make you walk on hot coals." "Oh, my God," that's terrible." Then the new arrival looked around, and in the distance he saw a little wall. There was nobody in South Korean hell but this little old man. So he crossed over the wall into a very crowded area, terribly crowded with millions of people. He asked "Where am I?" And the fellow immediately next to him said, "You are in North Korean hell." "Aha, I see, North Korean hell. Well, tell me—I must be in better shape here, he thought—what is the punishment?" "Well, there are three: they boil you in oil, make you walk on coals, and they stick you with hot irons." The sinner exclaimed, "Oh, my God, that's the same as in South Korean hell." And the fellow next to him said, "Yes, but two months ago they ran out of oil and iron and coal." [Laughter.]

Teleology aside, I do want to take a minute or two to talk about strategic issues in a broader context, and heretofore no one has mentioned North Korea at all. Of course, the economy of South Korea cannot advance if there is a North-South confrontation. There are also numerous other external factors affecting the South Korean economy. As you all know, one analyst recently referred to the "three blessing" which have resulted, in part, in South Korea's double digit growth rate: cheap loans, cheap oil, and the cheap dollar. And all of these factors are external to the Korean government and Korean economic decision making.

Other changes external to Korea can have a tremendous adverse effect on its economic growth. The Iran-Iraq war, for example, could alter Korea's relative dependency on oil and the price it pays for oil. To counteract this problem, Korea has diversified both its import and export markets; it is developing trade relations with China; and it is a leader in the Pacific basin economic development movement.

Threat preceptions play a very important role in South and North Korea. One important study on this subject comes to mind. Perceptions of threat for South Koreans are not necessarily heightened when they receive "demands". As Dr. Kim Kihwan argued, "If you make a demand on us, there's not likely to be a positive response, particularly if a deadline is set." However, any indication or hint of a withdrawal or reduction in the overall relationship between the United States and South Korea is terribly threatening.

Thus it is important for us to realize that threat perceptions vary depending on how we communicate with South Korea.

The South Koreans are intensely threatened by North Korea, and this threat perception has been constant and in some respects it is increasing. The reason it is currently increasing is related to the succession question in North Korea. Here is a situation where the information we have is very limited—but there are some interesting conjectures.

Kim Jong-Il, the son the Kim Il-Sung, has been selected to succeed his father, but there is evidence of major opposition in North Korea to that succession. First of all, Kim Jong-Il has yet to receive a formal government job; he has a Workers Party job, he is part of the Military Commission, but he has never received from the Supreme People's Assembly a formal government position. There is opposition to that in North Korea.

Secondly, there have been reports—and you have to take these with a grain of salt—of major opposition riots in 1982 and deaths, perhaps in the hundreds, in Ch'ongin and Sinuiju (on both the East and West coasts of North Korea). There were purges in 1983 of opponents to the transition. Kim Jong-Il himself disappeared from sight from 1977 through 1979. There are family factions opposed to Kim Jong-Il's succession. There's also an entire generation who are in their fifties and sixties who have been leapfrogged by Kim Jong-Il who is 46 and his cohorts. Kim has chosen leaders primarily among those from his own age group, and those who are older or closer to his father's age (75) are no longer significantly represented in the government.

So there's evidence of potentially strong opposition. Undoubtedly, there are also competitive, ambitious colleagues of Kim Jong-Il's who are seeking to take his place.

Now, the question is, what happens if there's insecurity in the transition in North Korea? South Korea has won the official bid to host the Olympics next summer. It's important to note that the Burma bombing (in Rangoon), which resulted in the death of seventeen people—of whom thirteen were top South Korean officials—occurred at the exact time of the International Parliamentary Union meeting in Seoul. It's quite possible that there is a link between Seoul's success and North Korea's insecurity. I'm not saying that North Korea is going to attack tomorrow with a frontal assault—that's a very unlikely probability. But they have a tremendous capability for commando infiltration and wreaking large-scale havoc. They even have some eighty American-made Hughes helicopters which they were able to get their hands on—its a long story—and tunnels under the demilitarized zone.

So the question is how stable is South Korea in terms of its economic development given this threat?

The other issue I would like to raise is North Korea's recent move towards the Soviet Union. There are two significant changes in the strategic situation stemming from North Korea's receipt of more military aid from the Soviet Union. One is overflights. For the first time, the Soviet Union can now offer vastly improved logistical support for its bases in Vietnam via direct over-flights of North Korean territory. Prior to this approval, the Soviets had to route their flights all the way around North Korea, South Korea

and Japan to make this connection. Two is Soviet naval visits to Namp'o on North Korea's west coast. Ultimately, the Soviets may have the opportunity to construct their own military facilities on the Yellow Sea directly across from the Shantung peninsula in China—and thereby acquire year-round warm-water ports for Soviet ships.

There's also the question of Afghanistan and the history of political transitions within countries closely associated with the Soviet Union. What might the Soviet reaction be to an unstable transition in North Korea or a political transition to a government they oppose?

To conclude, South Korean leaders over the past few decades have argued that Korea requires stability first before and even at the expense of democracy. I would suggest another way of looking at this formula. If South Korea has an economic reversal—and we hope not—there is a heightened probability for civil unrest. Rising expectations followed by an economic turndown lead to frustration and the possibility for instability which the North Koreans might exploit. So the democratic transition in South Korea is very important. I'm not saying that the United States should play more than an advisory role, but that the success of democracy in South Korea will lead to further stability and economic growth, and that in turn will lead to a successful Olympics and will protect the South Korean community against the kind of unpredictable actions that the North Koreans have taken in the past.

Thank you.

Mr. NIKSCH. Thank you, Greg. Let me just say a couple of things—and this will be extremely brief. I think it should be mentioned, that when it comes to the question of defense, there is no comparison between South Korea and Japan. South Korea bears a much heavier defense burden than Japan. It spends a much greater proportion of its GNP on defense than do the Japanese. Its financial contribution, to support American military forces in South Korea reached $900 million in 1983. While the figure is now classified, I assume is somewhat higher now. South Korea, for all of the smallness of its economy and of its budget in comparison with the Japanese, are spending about the same amount of money per capita to support American soldiers that the Japanese are spending today for the American troops stationed in Japan.

Now, very quickly on the political situation. I think Greg's comments on the North Korean situation and the changing relationship with the U.S.S.R. were very important. I am concerned about what I believe has been a very ineffective American job in reaching the younger generation of South Koreans. We have talked a little bit about student radicals and student demonstrations, but I do think that what we are seeing on the campuses today, even if this is a minority of the students, does reflect some very different attitudes now that are emerging among the younger generation of South Koreans. Their view of their government and of their government's relationship to the United States and of U.S. policy is shaped by very different factors than those that shaped the older generation of Koreans. Younger Koreans don't believe that the Korean war is the most important criterion in judging the role of the United States today. Out of these different sets of attitudes has

come a much more critical view of the American role, something that we have not done a very good job in dealing with. I think we are going to have to start doing a better job in dealing with it.

There is going to be an election coming soon in Korea. It may come as early as late this year under the present constitution; it may come at a later date, perhaps through a negotiated settlement between the two sides, perhaps through some other action by the present government. But if there is no agreement between the two sides, you are going to have, I think, an extremely volatile election in the Republic of Korea the next time around. The opposition may decide to contest, even under the present constitution—and it's not only going to contest the government, but, if this election is held under the present constitution, it's going to contest the system itself, the election system. If this occurs, I think you are going to see a different kind of ball game developing in Washington. The level of attention here, as in Korea, is going to get very high. You are likely to see the U.S. Congress taking some direct measures and actions that it isn't presently taking in this situation.

So I would say that if the two sides don't work things out—and I certainly hope they do—then we should watch for the next election, because we are going to have an extremely volatile situation that could produce a real crisis in ROK-U.S. relations.

With that, I'm going to set 10 minutes here for questions and comments, and at 4 o'clock we will take a very quick break and then turn to Panel III.

So could we have your questions, please.

QUESTION. A good deal of hope has been expressed by all of the participants in the prospect that the present political crisis will work itself out. But I think we would all be interested in hearing from both Professor Kim and from Professor Han, in terms of Korean attitudes, conflict-resolution behavior, what are the ways in which what now seems to be a stand-off between the government and the opposition—what are the ways in which such a stand-off can be moderated? What are the prospects that it will be?

Mr. NIKSCH. Dr. Kim, Dr. Han, do you want to take a crack at that?

Mr. KYONG-DONG KIM. I really don't know the political situation. I think people are going to play realistic, nobody is going to lose in the game. "Realistic" can mean different things to different people, but I don't think we are going to go right into the confrontation of the sort that would require or necessitate largescale violent street demonstrations and rallies and so on.

So the politicians will come out with some kind of solution, although not satisfactory to either of these parties or especially to the people in general.

But my sense is that they are going to be realistic. That's all I can say at the moment.

Mr. NIKSCH. Dr. Han.

Mr. SUNG-JOO HAN. I think there are a number of reasons why a compromise is not being reached and probably is not likely. One is the internal dynamics of each of the two parties, particularly the opposition party, that we are fairly well aware of. It's very difficult in that situation for any faction or individual tc come out as a compromiser, as it has been shown that he will immediately be brand-

ed as at best an appeaser, at worst a traitor. So there is an incentive to take a more extreme position than the other person.

Even though the situation is different within the ruling party, the government party, I think there is a certain dynamic there which makes it difficult to offer a very moderate position.

One can also talk about the peculiar Korean inability to compromise. And I think it is understandable in view of the fact that Koreans had been dominated by others, and any kind of compromise is in fact seen as a weakness, not only by the adversary but by his or the group's own allies and colleagues. And so I think both sides would not stop at any position of concession, but will want to even demand more, once this particular weakness is shown.

And so there is no real incentive to compromise.

Both sides are very suspicious of each other, particularly the opposition. In some ways, unfortunately, in the dealings between the government party and the opposition party, I see some parallel in the North-South Korean relationship. The same proposition, when made by the other side, even if it is a proposition made by this side, will be rejected simply because the other side made it.

On the technical side, I think there is a critical problem with the kind of constitutional committee that the National Assembly set up, which consists of basically government party members and opposition party members. And anybody who deals with any arbitration matter, negotiation, labor-management negotiation, will know that without a third party the two sides will not be able to compromise with each other. If you had Virginia and New Jersey, you would need a Connecticut—but we don't have a Connecticut in the committee. That's why I was hoping to propose a more independent committee which will have not only members of both parties but also people who do not belong to either of the parties but who would be acceptable by the two parties. I have not made the proposition because I was afraid that one or the other party might accept it so that the other party will reject it. [Laughter.]

Mr. NIKSCH. There's a question here.

QUESTION. I wanted to ask this question. You mentioned the difficulty of reaching compromise in Korea, and I don't know that that is unique in Korea—I think it's a characteristic of all authoritarian societies. The question I have is: What does democracy mean to Koreans? Is it something that Americans would recognize? And is what Koreans mean by democracy something that Americans really want?

Mr. NIKSCH. Someone want to take a crack at that?

Mr. KYONG-DONG KIM. Well, let me start with a general observation, that the issue that the Korean people are much more keenly interested in is not the kind of democratic political process that we see in the west in general; it's more of the issue of legitimacy of a government. And this legitimacy has to be rooted in some kind of moral righteousness. Now, that is our tradition. And I believe this is the kind of general perception of the population, that somebody in power should be morally also right; I mean, at least that sort of expectation is there.

Now, once you have that kind of legitimacy, then I think many people will be largely content with the kind of overall political process that may not look like a real democracy to many outsiders.

Mr. NIKSCH. I would just add that Korea did have one experience—and it's something that I think even Americans could say was legitimately a democratic experience, and that was the Third Republic from 1963 to 1971. Now, this was a rather rough-and-tumble kind of situation, as I remember it; and it was not marked with a lot of compromise. The level of competition was very heated at times, and there was a good deal of political turmoil. But in many ways it worked, and I think it worked in the way that Dr. Kim was talking about at the time. And I think in hindsight it's a system that might have continued to work and might have evolved into perhaps a somewhat tamer kind of atmosphere, if it had continued. President Park, of course, made the decision in 1972 to do away with that constitution, to suspend it and put in a more restrictive, more authoritarian constitution at the time.

So I think we can overdo or perhaps overstress that the Korean mentality or Korean cultural values or interpersonal relationships somehow are an almost insurmountable barrier to democratization. I don't believe that's true myself. There are problems, and their style of operating within a more democratic framework is going to be different than our style. But I don't believe it's out of the question that the Koreans can make something like the Third Republic experience, bring something like that back and make it work again in the future.

Dr. WINN. I just want to add one point, and that is to be successful in their democratic experiment I think Korea has to develop a multi-party system where there is mutual respect among the members of the National Assembly. Thus, if there is an election that has an honest result, then a transfer of government could occur where each side would accept the election results and have sufficient confidence in the skills and abilities of the new leadership. I think one common problem is that when each politician "plays" to his or her constituency or party leadership, there is a minimum of communication across party lines and often an absence of mutual respect. One thinks of inviting members of the National Assembly or other political party leaders to participate in meetings held in a more neutral environment. There they could learn to see beyond political party barriers that each participant has positive qualities and professional strengths. Only then could a transfer of political leadership work for Korea without resulting in some form of military intervention or implacable hostility between the winners and losers.

QUESTION. This question may come up in the next session, too, but the danger of nationalistic response to the U.S. increasing its pressure on trade matters—I mean, the nationalistic movement turning into anti-Americanism—I think the question of that danger has been mentioned in the panel discussion, especially by Dr. Han; also Mr. Kim earlier expressed concern on this.

But what I would like to ask the panel, especially the American colleagues like Mr. Plunk, to help South Korea move along the democratic path of development, what kind of measures should the United States take on matters of gently pressuring South Korea to open up its market but at the same time making sure that there is no negative feedback in terms of turning the nationalistic movement into the direction of anti-Americanism.

Mr. PLUNK. Your question reminds me of a similar question that was asked of someone at a function I attended a couple of weeks ago. The person being questioned was a Korean journalist. Someone asked him about American involvement and about what the United States should and could do. He paused for a minute, looked up and said "Either way, you will be blamed." The United States is going to be blamed by many people in Korea no matter what we do, although "blame" may be too harsh a word. No matter what happens, I think significant sectors of the Korean population will think, "Well, the United States had a hand in this." Hopefully it will be a positive resolution and we'll get some kind of credit for that.

It's a very interesting question, because, particularly after last year's scenario in the Philippines, everyone is wondering what might happen in Korea. Of course, I mentioned in my presentation that I think Korea is a very different case. The Philippines situation last year showed how limited the U.S. influence can be, except possibly at the very last minute. I know Larry was very closely involved in what happened in the Philippines—he was there for the elections with an observer group. But it seemed to me, when we got to the very brink and things were about to fall off into the void, the United States was able to finesse something there.

Until Korea reaches that point—and I don't think it will—U.S. leverage is very limited, although the Korean perception of that may be quite different. The opposition is constantly calling on the U.S. Government to speak out and condemn the ROK government for abuses, and also is pressuring the U.S. Government to speak out in favor of the opposition's political positions. But the U.S. administration is reluctant to get directly involved and hopes that the Koreans can work this out on their own.

It is an ironic situation in that, when we speak out on other issues such as the Korean economy or foreign policy, we are often criticized for interfering. For example, in the economic field, when we tell the Koreans to open their markets, we are accused of economic imperialism, but when we refrain from meddling in Korean domestic political affairs, we are accused of supporting the dictatorship.

So, I guess I should come full circle and say that, whatever happens, we will be blamed!

Mr. NIKSCH. Greg. This is the last comment.

Dr. WINN. I would like to add one additional observation. Working with the U.S. Information Agency, one of our roles is to try to facilitate the transfer of information, to make information available about the United States for foreign leaders to use on their own terms and within their own political and cultural context. To that end, we have developed a series of international workshops on the question of political transitions from military or authoritarian regimes to enduring civilian-dominated democratic systems. Here we try to create a comparative context wherein the leaders of different countries can share their experiences. This is one way to convey advice without doing it on a bilateral basis and participants are more likely absorb information or insights which are not force-fed. It's particularly important for the United States to provide—during this year of the Bicentennial of the U.S. Constitution—a forum for

leaders to share their experiences, gain insights which are of practical use, and create new and enduring avenues for professional communication. I think this is one approach for Korea we need to pursue.

Mr. NIKSCH. Well, I would like to thank you for your patience, and I would like to thank our panelists for what I thought was a very excellent and informative panel. Now is the time to quickly get up, get a cup of coffee, come right back to your seats, because when Panel III is set up they will begin.

Thank you again.

[Brief recess]

## PANEL 3.—AMERICA'S OPTIONS WITH KOREA: BUSINESS, CONGRESS, AND THE EXECUTIVE BRANCH

Peter F. Allgeier, Assistant U.S. Trade Representative for Asia and the Pacific.
Kent Hughes, Staff Director, Subcommittee on International Economic Policy, Committee on Foreign Affairs.

MODERATOR: William Cooper, Analyst in Economic Affairs, Congressional Research Service, Library of Congress.

COMMENTATORS:

Frank Phifer, Professional Staff, Subcommittee on Trade, Committee on Ways and Means.
Clyde Prestowitz, Former Counsel to Secretary of Commerce, Fellow, the Wilson Center.

Mr. COOPER. Our third panel is going to be discussing the American options with Korea in the context of United States-Korean trade. And I'd like to begin just by reviewing some of the major points of the United States-Korean trade conflict, as it's called in the title of this conference.

From the U.S. perspective, the United States is facing ever-growing trade deficits. In 1986 it reached $170 billion, and this is a problem that the executive branch and the Congress have come under pressure to deal with.

The U.S. bilateral trade deficit with Korea reached $7 billion in 1986. Now, this is small in comparison to the deficits we face with Japan and other countries; nevertheless, it's growing and it is of some concern.

U.S. businesses are facing increasing competition from Korean firms in such highly visible products as consumer electronics, cars, computers, and this is making Korea a highly visible target in the eyes of the executive branch and the Congress.

U.S. businesses point out that they face major obstacles in trading with Korea—high tariffs, import licensing requirements, and other trade barriers—while the Koreans are permitted to trade in the United States virtually unimpeded.

From the Korean perspective, there are a number of sensitivities. Exporting is the driving force of the Korean economy: approximately 40 percent of Korean GNP depends on exports. At the same time, the United States has been Korea's primary export market, accounting for approximately 40 percent of total Korean exports. Korea is also a major debtor nation—we've heard this referred to several times this morning. In 1985 its external debt reached in the neighborhood of $48 billion, and while it has avoided the problems that the Latin American debtor nations have experienced, it never-

theless must service this debt and try to retire it. To do so, it needs trade surpluses.

Korea earned its first overall trade surplus in 1986, I think in the neighborhood of $3.5 billion. While it manages large trade surpluses with the United States, it still incurs continually large trade deficits with Japan.

I think the focus of this afternoon's panel should be on the question of how the United States can address and remedy its trade deficit, its trade problems, with Korea while at the same time taking into consideration the sensitivities of the Korean economy and the other U.S. interests in Korea, strategic and political interests.

We have a very distinguished panel to address these questions, all with extensive experience in the field of trade and experience in Asia.

Peter Allgeier is the U.S. Assistant Trade Representative for Asia and the Pacific, and consequently is on the front line in dealing with the Koreans and other Asian nations in the area of trade. Kent Hughes is the staff director of the House Foreign Affairs Subcommittee on International Economic Policy and Trade, and has therefore played a very important role in the trade legislation. We will also hear comments from Mr. Clyde Prestowitz who was formerly the Counselor to the Secretary of Commerce for Japan Affairs and also has done some work at the Wilson Center. And Frank Phifer will be also giving us comments; he is with the Trade Subcommittee of the House Ways and Means Committee and has, I believe, a little bit of experience in trade legislation.

So on that note, Peter, if you'd like to begin.

## STATEMENT OF PETER F. ALLGEIER, ASSISTANT U.S. TRADE REPRESENTATIVE FOR ASIA AND THE PACIFIC

Mr. ALLGEIER. Thank you very much, Bill. I will stick to the topic, but I think I'll approach it not so much from trying to describe what the U.S. options are, but at least initially to talk about what our perception of Korean trade policy is, and what is the likelihood of its success in the future, and specifically how the likelihood of success depends upon the U.S. reaction to that policy, or changes in that policy.

I won't go over the economic performance of Korea, or the trade performance—everybody in the room knows that very well. And Bill has already highlighted the fact that the United States is the largest export market for Korea.

But beyond being the largest export market, we play a crucial role in the economic transformation that's taking place in Korea. If you look, as he said, at overall exports, we take something under 40 percent. But when you start looking at what really are the leading export sectors for Korea, and those sectors that are important to their economic transformation, we are even more important than that. So, for example, if you were to take the nine sectors that Korea exported a billion dollars each in 1985, you would find that in five of those sectors the United States took more than 50 percent of Korean exports, and in another three of those sectors the United States took the largest single-country share, although it wasn't an absolute majority. It was only in transportation, in which ship-

building figured so heavily, that the United States was not the largest export market for Korea.

If one disaggregates those numbers one step down and looks at subsectors, the things that have been really dynamic, that are the leading edge, if you will, of Korea's export drive, one sees that we are even more important there. For example, in 1986 the United States took 90 percent of Korea's exports of computers; we took 71 percent of its exports of aircraft engines; and 65 percent of its exports of telecommunications equipment.

So the pattern is one in which when Korea is moving into a new area of production and export, it depends overwhelmingly on the United States market. And the reasons are fairly simple. The domestic market in Korea is not large enough to generate the economies of scale that one needs in these areas to be efficient. The Japanese market is largely closed, and the rest of Asia, although it's more open and it offers some promise, is not a large enough market yet.

So this has been the pattern of Korea's export development and the economic transformation behind that. At this point one would have to judge that for the next several years at least the direction, will remain the same because these other markets are not going to develop fast enough or they are not going to open fast enough for Korea to reduce significantly its heavy dependence on the United States.

This dependence on the United States market is really risky, because in most of these sectors—electronics and telecommunications and computers and automobiles—the Korean shipments are in addition to shipments from Japan. Korea is not displacing Japan. It may be that Japan is moving into other lines of production within these sectors, but in terms of the overall import penetration of the United States market in things like machine tools and computers and telecommunications, Korea's import penetration numbers are going on top of the Japanese numbers. And that is why the attention of a lot of people in the public, in the business community, in the Congress, is drawn to Korea, and why one hears people saying, that, Korea is "another Japan". In a neutral statistical way, Korea like Japan is achieving envious economic development: it's using trade effectively, it's becoming competitive and it's penetrating our market. There's nothing wrong with that. The real danger is that if people's perceptions may transfer to the Japan policy model and say, well, Korea is also a second Japan in terms of not providing adequate reciprocity to U.S. products.

As we look at Korea's trade policy, at least from the executive branch, we see two streams. One is a stream of liberalization, and the other is what I will call localization. One has to note that especially since 1980 there has been liberalization of the Korean import regime. There is a 5-year tariff reduction plan. More and more items are moving to automatic approval in the import licensing restrictions, and more sectors are being opened to foreign investment. And very few developing countries have been moving unilaterally to set up a liberalization schedule. Obviously that is very positive from our standpoint.

Despite these liberalization steps, however, there is in place in Korea, and there has been for a long time, a thread of localization

in which various policies are used to encourage import substitution in selected industries. So even though an item is on automatic approval, there are a number of laws in Korea—laws such as the telecommunications basic law, the pharmaceutical law, the science and technology development law—that give individual ministries authority to impose import restrictions for a period of time, to set up local content requirements, and to direct procurement. This is done to encourage the indigenous capability in these sectors that are undoubtedly going to be important for the future. There also is localization in the agricultural area, but that's for a different set of reasons.

If you look at this trade policy of localization and gradual liberalization over the last couple of years and you look at the economic performance of Korea and its trade performance, you would have to conclude that it's a very successful strategy. If you were Korean, presumably you would say let's keep this policy, it's a very alluring policy.

But there are some real constraints on Korea's ability to do that, and primarily they are constraints imposed by the reality of its relationship with the United States. Korea, as it has become a more important trading partner and a source of more of our deficit, is getting a lot of attention. There is a feeling, a strong feeling, in the Congress—the press, the business community, and the executive branch, that the United States is not getting a completely fair shake from Korea, that Korea should be opening up faster, given the access that it has to this market.

And we've already seen steps that the U.S. Government has taken to use our trade law more aggressively over the last couple of years, using section 301 and the GSP and so forth. Currently there are even more radical proposals in Congress, such as the Gephardt amendment.

So the situation, as I see it, is that the very policies that Korea has been following successfully over the last few years have been eliciting a strong response from the United States which really raises doubts about the ability of Korea to pursue this policy any further.

I want to talk briefly about a couple of policy options that Korea has, and that by implication we have in our bilateral relationship with Korea. I would like to stress that my discussion of these courses of action are purely personal comments; they shouldn't be construed as official U.S. Government policy. Just looking across the spectrum of options, however, these are the things that would occur to one.

The first option would be simply to hold the course, stay the course, continue this gradual liberalization with localization. As I said, although it's alluring it is almost certain to provoke a reaction in the United States either one that is mandated by the Congress or one that the executive branch takes on its own.

The reaction would be to insist upon opening the Korean market, and, in the absence of opening the market, to take import restrictive measures against the very items that are most important to Korea's transformation to industrialized status and in the very sectors in which resources in Korea have been directed most recently.

The risk in that is both economic and political. One, the economic risk that I described, but then the political risk of the government in Korea facing a choice of either capitulating to the United States, which would cause political difficulties, or continuing to have this antagonistic relationship with the United States, which would raise a different set of political difficulties.

So that's option one, and I really don't think that is a viable course.

The second option I would call accelerated liberalization and diversification of export markets. Actually we already have seen the Korean government begin to try to diversify its export markets to break this dependence on the United States. The focus has been on Japan and China.

China is interested in developing its own manufacturing and export capability in things like electronics and machinery and transportation. It's not clear to me that China is really going to be interested in importing a lot from Korea. What China would really like from Korea is more investment and technology transfer, and it's not clear why Korea would want to do that with a country like China which is already a competitor and has aspirations of being even more competitive.

I won't get into details about Korea's attempts to open the Japanese market. Suffice it to say that they haven't found the magic key there any more than anybody else has, so there's a high degree of frustration in opening up that market.

The rest of Asia and the Pacific in the longer run does offer some possibilities. Over the last ten years, Korea's exports to the rest of Asia and the Pacific have grown at an average rate of about 24 percent. These countries' import regimes are more porous than the Japanese import regime; incomes are rising in Southeast Asia. So over a longer period that should be a good way of diversifying Korea's export market.

But even if that is achieved, American demand is going to be the crucial factor in these new products, the leading-edge products.

The other part of that would be to greatly accelerate the liberalization of the import regime in Korea. That would consist of a number of things. One would be to move all items very rapidly to automatic approval, and that probably wouldn't be all that difficult, at least in manufactured goods, because they've gone so far. More difficult would be to phase out the remaining restrictions on foreign investment, and most difficult would be to really foreswear all these localization requirements and to open up agriculture.

But that would exorcise the demon of Korea as a second Japan.

In terms of its dealing with the United States, therefore, acceleration of liberalization and diversification of export markets would be a viable course.

A third course, which again is clearly not U.S. Government policy, but, as you think about the possibilities, you can't help but at least ponder it, is some sort of a free trade arrangement with the United States along the lines of the United States-Israel free trade area. That would have a number of advantages for Korea. First, it would provide its infant and adolescent industries with a sure basis on which to achieve the economies of scale that it needs and would give it unlimited guaranteed access to the market that

matters most. Moreover, it would be an extremely powerful incentive for attracting foreign capital and technology to Korea. There could be some advantages for the United States as well. One, it would give us unimpeded preferential access to the second largest market in Asia, and, two, it would provide us with a lower-cost production partner that would help us in our competitiveness, in our joint competitiveness, in Southeast Asia, China, and in Japan itself.

Obviously a lot more study would have to be done to determine whether such an arrangement would be in the economic interests of each country, but it is the sort of thing, in this kind of a setting when you are looking at a whole range of options, one has to look at.

In closing, I would simply say that whatever course of action Korea and the United States take, I remain very optimistic, because even last year, when we were in the midst of these rather unpleasant negotiations and confrontation on these 301 cases, it was really evident that on both sides there was a very strong determination by the government officials to make sure that this relationship does stay managed in a positive way so that it will be mutually prosperous.

Thank you.

Mr. COOPER. Thank you, Peter. Kent?

**STATEMENT OF KENT HUGHES, STAFF DIRECTOR, SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY, HOUSE COMMITTEE ON FOREIGN AFFAIRS**

Mr. HUGHES. Thank you. Let me say that, like Peter, I am very much speaking for myself and not for the Congress or for the Committee for which I work. Bill asked me to say a few words about how the Congress sees Korea and how the Congress might react to growing trade tensions. In many ways, the congressional view, at least to my eye, reflects the full panoply of things that you've heard this morning and this afternoon. There's no question that many in the Congress continue to look at Korea through a national security prism. There are, after all, 40,000 American troops still there; there's wide awareness that there is an aggressive and seemingly unpredictable regime to the north of South Korea, and that Korea is part of an ongoing broader commitment to a U.S. presence in East Asia.

Increasingly, Korea has also been looked at through a political prism. There is a considerable concern among some congressional quarters about the prospects for a transition to democracy in 1988. Many in the Congress are worried about the human rights situation in Korea. It is increasingly common for congressional delegations, when they visit Korea, to ask to see some of the people who are active in the opposition movement, one or the other of the Kims.

There has also been a growing concern about workers' rights, something that quickly gets into the trade arena as well. The interest in workers' rights I think is threefold. One, it is viewed in part as an aspect of human rights; second, there are many in the Congress who see a free labor movement as one of the building blocks of an effective democracy; and, third, there is this interest in work-

ers' rights as a trade phenomenon—and, again, I think there is a mix of interests. In part it is applying the concept of export subsidies to wages. If you are granting a capital subsidy or an export subsidy to a particular industry, you are almost surely violating one international standard or another. So some people in the Congress are extending that concept to the idea of a differential subsidy in terms of lower wages for a particular export industry.

The broader interest, though, grows out of the sense that low-wage competition across the board is somehow a long-term problem for the United States. The specific economic proposals for workers' rights, however, generally focus on standards that are appropriate for the level of development of the country in question. If, for instance, a proposal is advanced for minimum-wage legislation, they are not thinking of the minimum wage as currently applied in the United States.

There's no question, as Bill suggested, that there is a lot of interest in trade with Korea. The Congress has watched Korea move, in just a few years, from traditional manufactures—apparel, textiles, and so forth—to heavy manufactures—shipbuilding, autos, steel—to the high-tech area where Korea is now a producer of 256K random access memory chips. People who follow the trade debate in the Congress can remember not too long ago, in the late seventies, when the debate was over 16K chips. One school of thought was advising the Congress that, well, the United States will leap ahead to 256K chips; another group was saying that those are technologically so sophisticated that they'll never really be brought into commercial production. And here, just a few years later, Korea is entering the 256K market.

So Korea has the attention of the Congress on the trade side.

There's an interest in the currency question, the exchange-rate question, which is also tied to trade matters. Senator Baucus, for instance, in the Senate, has proposed action against countries which are viewed as manipulating their currencies by tying them to the dollar. In the case of Korea, it's my understanding that the Korean won is tied to a basket of currencies; that basket is generally not made public. In practice, the won does seem to track fairly closely the value of the dollar. You will find, for instance—I know Frank will speak more to this—that in the Ways and Means titles of the House trade bill that are now being stitched together, there are provisions dealing with currency manipulation for trade advantage.

DEBT

Korea has been such a success in handling its debt that often people forget that it is one of the world's largest debtor countries. At one point Korea vied with Argentina for being the third largest debtor in the developing world, but has, in fact, now paid down a bit of its debt and is solidly in fourth place—or fifth place, if you add the United States to the equation.

The question of debt I thought was well-framed by Bill. There is an understanding in the Congress that if you are going to service debt, you are going to do that in one or two ways: you either borrow more money or you are going to have to have some kind of

trade surplus. In fact, in the Gephardt amendment that Frank will also discuss at more length, you will find that one of the waivers granted to the president is one for a country that is a significant debtor nation and therefore has to be running some kind of trade surplus.

The final aspect of the trade debate is something that Peter addressed at some length, and that is the question of is Korea the next Japan. The concern about Korea is part of a general sense that the Japanese model is spreading. Many people have in mind two basic approaches to international economics, one built around the assumptions which underlay the GATT—open markets, competitive markets, relatively little government intervention, and probably some sort of effective anti-trust policy at home to keep markets competitive. As people look at Japan they find that Japan has violated almost all of these rules of thumb, and yet prospered. There is a concern that not just Korea but much of east Asia, southeast Asia, and, increasingly, Latin America will also look to the Japanese model. I think if we were discussing Brazil today that the candid Brazilians would say they'd like nothing better than to be the next Japan. And since they moved away from an import-substituting industrialization model, they have thought more and more in Japanese-like terms.

What to do about all this? Peter's options were ones that ought to be considered very seriously. And let me throw out a couple of ideas that really would try to complement what Peter said. In fact, I think you will see continued U.S. pressure on a sector-by-sector or product-by-product basis, a problem-by-problem basis. I suspect that U.S. initiative will take into account Korea's current situation, both its strategic position, its transition to democracy, its debtor status, and so forth. And the extent to which Korea is in fact not like Japan. If you look at some of the steps that Korea has taken recently, there seems to be a conscious desire on the part of Korea not to fall into that we-are-like-Japan category.

In the longer term I think the United States will have to limit its pressures to where there is a strategic economic interest for the United States built around our own long-term comparative advantage.

The question of how to deal with very different economies, including Japan-like economies, will probably require broader rules of the games, rules that really are not yet part of the GATT system. The workers' rights perspective is in some ways a proxy for the fact that we do things differently on the social insurance side. I think it's interesting, in the context of the Canadian free trade talks, that at least in theory everything was put on the table, including the Canadian approach to social insurance, which is generally viewed as being more expansive than our own. It may be that at some point further down the road we will be talking with the Koreans and others about some sort of rules of the game in this context which would go beyond just dealing with targeting and so-called neo-mercantilism.

Well, let me end there and turn it back to Bill and our commentators.

Mr. COOPER. Thank you, Kent, for your observations. Frank, would you like to lead off the commentary?

Mr. PHIFER. Thank you. Let me also say that I am here in a personal capacity and not representing the Congress. But I do want to say on behalf of the House Trade Subcommittee Chairman Sam Gibbons, that he and the other Members of the Trade Subcommittee do appreciate the Congressional Research Service and the Wilson Center sponsoring this conference. He strongly believes that any time we can get together a panel with Korean scholars, as we have today, we can improve mutual understanding in these important matters. He also told me this afternoon that he wanted to stress that he strongly believes in the importance of the United States-Korean economic relationship as well as, of course, the security arrangements that we have between our two nations.

One thing that many members of the Trade Subcommittee feel very deeply about is their concern about Korea and the other east Asian newly industrializing countries' apparent refusal to take broad liberalizing actions in the trade area. Many believe that Korea has the responsibility to open its markets to American services, products, agriculture, foreign investment, in a commensurate manner with its increased development.

Now, obviously, the trade deficit situation is driving this, but I guess the real question would be why is the Congress so intensely interested in trade. And there's been an avalanche of bills introduced in the 100th Congress, as there was in the 99th Congress, dealing with trade and with the new round of GATT talks, and also dealing with bilateral arrangements between various countries.

Is it just demands from constituents for protection from foreign competition, or is it the trade balance? Is it the shift in that debtor status for the first time since 1914? Or the massive foreign capital inflow that has been financing our budget deficit? Probably most importantly, at least on the Trade Subcommittee, seems to be the perception of unfairness that both Peter and Kent mentioned earlier. And this, of course, involves everything from export-driven economies that maintain infant industry protection, to subsidies, dumping, and investment restrictions and so forth.

Now, really the Congress can go two ways. The Congress can enact sector-specific protectionist legislation, outright protectionist legislation—and many believe last year that the textile quota bill, which would have drastically affected the Korean economy, is an example of this type of sector-specific legislation; or the Congress can respond by passing generic comprehensive trade reform legislation, which is what the Foreign Affairs Committee and the Ways and Means Committee and other committee have been doing the past few weeks to meet the Speaker's program of a comprehensive trade bill on the House floor by the end of April.

Other speakers have mentioned that the American market is the largest market for Korea. I would also say it's important for the Koreans to realize that the American market is the most open market in the world today, and will continue to be. And I believe that members of our subcommittee and full committee, when they are writing this comprehensive trade bill, want to maintain it as the most open market in the world. It's interesting to note that many members who have supported trade reform actively opposed the textile quota bill last year. That quota bill would have greatly restricted Korean imports in footwear, textiles, and apparel prod-

ucts by placing permanent statutory quotas on the product categories that could have been imported. Obviously the textile bill is a problem. The President's veto of the quota bill was only sustained by eight votes last August, and this year, in the 100th Congress, a new textile quota bill has been reintroduced, slightly different, applying global quotas rather than country quotas. And it already has 165 cosponsors in the House and forty-five Senators in the Senate.

Let me mention a little bit about our trade legislation that the committee passed last week. This bill, first of all, procedurally, has a long way to go. It still needs to pass the House floor; it has to be acted on by another half dozen House committees in areas that are within their jurisdiction. And, following the House passage, the Senate Finance Committee has to take action on it and the Senate floor has to take action on it. And, finally, a House-Senate conference would have to reconcile their differences.

So anything that you read about the trade bill is still very preliminary. But it is significant that the Ways and Means Committee has acted on some very key areas. We do not believe that this bill is a protectionist bill, although there are some controversial provisions. It is basically generic and avoids any sector-specific approaches. The broad bipartisan support in the Ways and Means Committee does indicate the depth of sentiment in the Congress that our trade laws and policy need to be strengthened, time frames need to be shortened, and new policy tools need to be put into place to improve U.S. competitiveness.

Let me just mention a couple of quick provisions that I believe are of special interest to Korea that the committee approved. We made broad changes in section 301, section 201 of the trade laws, the unfair trade practices import relief sections. We changed the legal tests in antidumping and countervailing duty law. We increased intellectual property right protection. And we authorized trade negotiating authority and objectives for the new round. And, finally, we strengthened the trade policymaking apparatus.

I'd like to talk about a couple of provisions that the committee took action on with respect to what is known as section 301 of the Trade Act, because this represents a government-to-government action and may be of special importance to Korea.

First, as Kent mentioned, the workers' rights provision found its way into the committee bill. And let me just mention how they handled it. The workers' rights provision basically became an amendment to the term "unreasonable trade practice," which is currently found in section 301, which authorizes certain sanctions and possible retaliation for unreasonable or unfair foreign trade actions. And what the workers' rights language does is it enumerates examples of workers' rights that may be violated. And let me just tick them off here real quick: Any act, policy, or practice that denies to workers (1) the right to association, (2) denies workers the right to organize and bargain collectively, (3) prevents any form of forced or compulsory labor, (4) fails to provide a minimum age for employment of children, and (5) international standards on wages, hours of work, occupational safety and health.

Now, there's a waiver provided here that the U.S. Trade Representative may determine that the practice does not exist during his

review of this. And if the country in question has taken steps commensurate with its overall economic advancement, then it is possible that this action can be waived.

Now, this is not a mandatory action; this is in the law as an example of what an unreasonable practice can be.

There is another provision under section 301 known as export targeting. This provision would specifically make actionable, under 301, a policy or practice of a foreign government that is called export targeting, if it significantly burdens or restricts U.S. commerce. And, again, there is a waiver provision here that the USTR and the president can waive this if it's not in the national economic interest. The definition of "export targeting" is any coordinated government plan or scheme that consists of a combination of actions or coordinated actions that, when carried out jointly or severally, is bestowed on a specific industry, enterprise, or group thereof, which would assist that enterprise or group to become more competitive in the export of its product.

Finally, without getting into too much detail, I would like to talk briefly about Congressman Gephardt's amendment. Mr. Gephardt is a member of the Ways and Means Committee and the Trade Subcommittee and has worked very hard to come up with language that he believes would deal with the unjustified and unwarranted trade surpluses.

Let me first mention a procedural thing that Chairman Rostenkowski and Chairman Gibbons came up with a modified version of the Gephardt language from last year's trade bill. And that is the language which I'm going to talk about and which was approved by the committee last Thursday. Congressman Gephardt, we believe, will ask for a rule to take his original amendment to the House floor for debate and vote, and his original amendment and provisions are somewhat different than the ones I am going to describe here.

Basically, it's a four-step process, and it involves, first, the International Trade Commission making an annual determination whether a major U.S. trade partner has an excessive trade surplus—and this is done through a ratio formula of bilateral exports, imports, and generally the test would be $3 billion or more to qualify that. If that is met, then the United States Trade Representative would have to make a second determination, and that would be to determine whether a pattern of unjustifiable, unreasonable, or discriminatory policies exist, that is, unfair trade practices, that had a significant adverse effect on the U.S. economy and it contributed to that surplus. And this would be based on what we call the trade barriers report that the USTR puts out. It's an annual volume, a collection, an encyclopedia, if you will, of trade barriers of U.S. trading partners. So that would be a basis for that.

After those two determinations are made under the Gephardt amendment, then there would be mandatory negotiations with a country so identified. And the negotiations with those countries would be to achieve a more balanced and reciprocal trading relationship. And the goal would be to achieve a substantial reduction in their pattern of unfair trade policies and to reduce the burdens and restrictions on U.S. commerce. There is no dollar amount or percentage amount involved in the committee version.

If, after six months, there is no satisfactory conclusion to these negotiations, then the President is authorized to take all actions that he could have under current law, under 301, to retaliate, to suspend the trade agreement, and so forth. The remedy is based on the principle of reciprocity.

Finally, there is a waiver authority, and that waiver authority would be that the USTR could waive any action under this provision if it would be deemed to be causing substantial economic harm to the U.S. economy.

And, finally, there is an additional test which I will mention, and then be glad to take questions on it, and that deals with currency manipulation. Part of the Gephardt amendment goes through the same type of determinations, negotiations, and possible action with respect to currency manipulations. And the language generally, which is still being drafted—and this is not the final language, we only approved concepts last week, the committee staff is in the process of drafting legislative language and report language to spell all this out—but the idea is that if an excessive-surplus country maintained a currency that was artificially low and does not reflect that country's underlying competitive economic conditions in the world market, then the president would be directed to take action. Those actions could be tariffs or possibly an exchange-rate equalization tariff, and that hasn't been finally drafted yet. So we are trying to still work on that.

But that's basically it, and I'll be glad to take questions on those provisions.

Thank you.

Mr. COOPER. Thank you, Frank, for the very concise description of the trade legislation.

Clyde, would you like to make some comments?

Mr. PRESTOWITZ. Thank you. I was struck by the number that Peter mentioned to us of a $7 billion trade deficit with Korea. I came to Washington first in the fall of 1981, and at that time the trade deficit between the United States and Japan was about $8 billion. And I remember a conversation I had with Secretary Baldrige at the time. We talked about what I was going to do and conditions of employment and so forth, and I noted that the salary that he was proposing to pay me was somewhat less than I was making. But he said not to worry about that, because he said that he would be glad to pay me a bonus of 10 percent of the amount by which I reduced the trade deficit. [Laughter.]

I owe him about $6 billion. [Laughter.]

I'm going to, I'm afraid, bring a bit of a cloud into the room here. I think that the United States and Korea, just as the United States and Japan, are heading for major, major problems. I think that the fact is that, while there certainly are a lot of differences between Korea and Japan, the fact is that in the organization of its economy and its policies towards economic development and its policies towards trade Korea resembles Japan to a great extent.

There is a fundamental point. The fundamental point is that Korea and the United States do not share the same view of what economics is about. Korea and the United States do not share the same view of what the purpose of trade is. As long as the United States was an overwhelmingly powerful economy, accounting all by

itself for 40 or 50 percent of world GNP, and as long as Korea was a small economy, it was possible to accommodate this difference of view because the friction that the difference resulted in wasn't very large, it didn't matter very much, it didn't hurt the United States very much.

But as Korea grows, and that deficit of $7 billion in 1986 will surely be larger in 1987 and it will surely be larger in 1988—it will be bigger, unless some protective steps are taken by the United States. I don't know if Peter has done this—I'm sure somebody has projected where this deficit is. Again, let me hearken back to my early days in the Commerce Department. In 1982, Frank Vargo, an economist at the Department of Commerce, made a projection that by 1990—by 1990, Frank said—the United States would have a $50 billion trade deficit with Japan. He was laughed out of the room. I remember presenting that figure to a meeting of at that time the Trade Policy Committee, and the learned economists from the Council of Economic Advisers and the Treasury Department laughed, they ha-ha'ed, they said that's absolutely impossible, the exchange rate will adjust all this and it will never get to $50 billion. Frank was wrong: it happened in 1985, not 1990. The same thing is going to happen here.

The policy of the United States of asking Korea to open its markets is a snare and a delusion. Korea cannot open its markets. Earlier I asked the question what Koreans understand by democracy, and the response was something that Americans might not recognize as democracy. Korea does not know what "open" means; neither does Japan; neither do a lot of other countries. I'm not saying it as a pejorative term. I am simply saying that Americans ask people to be open, and Americans assume that everybody knows what "open" means. But "open" is a word that comes loaded with a lot of implicit meanings. To Americans "open" means "due process," "open" means that—it's kind of mind-boggling actually, but here we have a staff member on the House Ways and Means Committee explaining in great detail to a room full of interested people, including many Koreans, what the proposed trade law of the United States might do and how it might affect them. And I notice many people taking copious notes here. It is inconceivable that a similar gathering in Korea would take place and that Korean officials would explain in an open meeting to a large group of people, including many American trade officials, what changes they were proposing to make in their laws and how they were going to carry them out. But to Americans that's what "open" means. It means that when this bill is marked up, anybody can go down to the hearing room and watch it being marked up. That's "open" to Americans. The Japanese don't understand that, neither do Koreans, neither do many other people.

"Open" means that if you have a supplier and an alternative supplier proposes a deal to you that you are willing to change. You might change your buying relationship based on a contract not on a personal relationship. That's what "open" means to Americans. It's interesting that Hyundai has sold nearly 200,000 automobiles in the United States. What's more interesting is who they sell them through. They sell them through dealers. Most of those dealers also sell Chevrolets, Fords, and Chryslers. Now, the dealers are

not selling Hyundais because Chevrolet, Ford, and Chrysler like them to do it; they are selling Hyundais because the anti-trust laws of the United States make the dealer an independent businessman who cannot be controlled by the manufacturer. That's what "open" means to Americans. There are no Hyundais being sold in Japan. Why is that? Well, because if a Toyota dealer even winked at a Hyundai salesman, he would wind up in Tokyo Bay with cement around his legs. [Laughter.]

So what I'm trying to say is that our idea of what "open" is is based, to a tremendous extent, on our own cultural-political background which is not shared by Korea or Japan or many other countries, and they don't know what "open" means.

I have seen in my own negotiation with both Korea and Japan—I have even seen officials of those governments trying to respond, trying to open their market, honestly, sincerely trying to be open. But they can't respond, because they really don't know what the procedures of open are.

So for us to ask them to be open is really asking them to be like us. And they can't be like us, because they are not like us. And they are not going to open. And when they don't open, then we are going to, as we are doing right now with Japan, accuse them of being unfair and of cheating, and they are not going to like to be accused of being unfair and of cheating and they are going to accuse us of not trying hard enough. How many people have heard that—you don't try hard enough. I wonder if the Koreans hear that from the Japanese, that they don't try hard enough.

But the fact is that it's not a matter of trying hard enough, it's not a matter of willfully closing a market or cheating. The fact is that we do not share the same underlying assumptions of what economics is all about, and therefore it's not going to work.

Now, since Korea cannot open and since the trade deficit is going to get a lot bigger with Korea, this is going inevitably to cause a great deal of strain, more strain, in the relationship. But it's even worse than that—it's even worse than that. Because that would happen if the status quo remained more or less as it is, with the United States growing at, say, 1 or 2 percent a year, and a reasonably good economic situation in the United States. But the economic situation in the United States is going to get a lot worse. Someone mentioned earlier that we are now the biggest debtor, and everybody kind of laughed—ha, ha, ha. It's not funny, it's real serious. By the end of this year we are $300 billion in debt; by the end of next year we are $450 billion in debt; by the end of this decade we cannot prevent ourselves from being close to a trillion dollars in debt by the end of this decade.

Now, the United States is going to have to run a trade surplus—it will run a trade surplus at some point in time. And that point in time is not thirty years from now. I don't know if it's in the next three years or in the next five years, but it's sometime in the relatively near future that the United States is going to run a trade surplus. It can run a trade surplus either by exporting more or importing less or some combination of the two.

Since it's very unlikely that the United States is going to sell a lot more to Japan and since Japan is the biggest market—there is no other market that can absorb that amount of goods. That means

that the United States is going to buy a lot less, and it's going to buy a lot less from the countries with whom it now has a big trade deficit. And one of those countries is Korea.

So if a downturn or a halt of exports from Korea to the United States is going to have deleterious economic and political effects on Korea, then count on it, because that's what's going to happen. And that's what you, as policymakers and influential people, ought to be thinking about.

What to do about it? I think there is really only one thing to do about it. I think that farsighted statesmen in the United States and in Korea would (1) recognize that this is going to happen, and (2) sit down now and think about how to handle it.

And that negotiation ought to forget about free trade, it ought to forget about the GATT, it ought to forget about fair and unfair, and it ought to ask itself the question: Where do we want the United States-Korea relationship to be in five years? And what steps do we have to take to do it? Now, since we know that Korea cannot open its market, the United States ought to forget about asking Korea to open its market. The United States ought to think about what it wants. Does the United States want to make 256K RAM's for example. If it does, then it has to make a deal with Korea, and the deal has to be that Korea gets some share of the U.S. market, and that's it; and the United States gets some share of the Korean market, and that's it.

I know this sounds unreconstructed, protectionist and so forth, but let me use an example. A lot of you people here fly between Washington and Seoul; you fly on Northwest, you fly on KAL. You all get there, the service isn't so bad—Northwest is not so great sometime; the price is not so bad; and it's not free trade—absolutely not free trade, nothing to do with free trade. But we negotiate deals. Now, why do we do that? Well, the United States knows that Korea, like every other country in the world, has to have an airline, not for economic reasons, but because you can't be a real country without an airline, it's part of national sovereignty.

Now, our economic theory—Keynes and Adam Smith and David Ricardo that we keep spouting all the time—says that you ought to have free trade in airline services. But we don't insist on that; we don't demand that Korea open its airline market, because we know that that's ridiculous, they are not going to do it.

So we adjust and negotiate a deal. It's not free trade, but it works pretty well. We are going to have to do the same thing in lots of other industries.

Thank you very much.

Mr. COOPER. Clyde, I think that was more than just a dark cloud; I think that was almost a thunderstorm coming. I appreciate your comments.

I want to thank the panelists for being very concise with their comments, because, on account of that, we've got about 20 minutes for questions. Before I take questions from the floor, I would like to ask Peter or Kent if they have any responses that they would like to make to what was said.

Mr. ALLGEIER. I'd like to make a couple of quick comments on some of the things that Clyde has said. And the seriousness of his remarks, I think, really calls for a slower response, because it does

deserve careful thought. But a couple of things occurred to me while he was talking.

One, there are some reasons for talking about Korea resembling Japan and talking about the parallels with the relationship there. But I think that the situation is somewhat different in that, frankly, we do have more leverage with Korea. And the same degree of resistance that we have encountered with Japan is not sustainable in Korea because of the greater dependence upon us.

The other thing, he says we cannot assume that people know what "open" means or that people use the same sense of "open" that we do. That's true, even in spite of the large number of Korean government officials in the economics area who have been trained in the United States who have Ph.D.'s in economics, and who I believe absorb that training and continue to act on the basis of it. When we start to talk about specific market openings, we do find that "open" does mean something different. I think that our experience with Japan in the first instance, but also with Korea and some of our other trading partners, is that therefore we become much more specific in what we mean by "open." We don't simply say: would you liberalize computers. But we start to talk about the laws that exist and what sorts of changes are needed.

This became very clear when we were doing the negotiations on intellectual property. We didn't just say "effective patent protection;" we got down into very great detail, and in copyright, thanks to some of the people who work in this building, we got into detail that went way beyond what most trade negotiators know.

So that we are aware that we can't just assume that everybody knows what "open" is.

What we do about it, sitting down and cutting these sorts of deals that Clyde was talking about—the only thing that I would say is that it would be incredibly resource-draining, and in a dynamic economy I just don't see how we can cut that many deals and keep modifying them, going through iterations of new deals, as our economies change.

Thank you.

Mr. COOPER. Thank you, Peter. Kent, would you like to make a comment?

Mr. HUGHES. I just would like to make a call for you to have a conference on just this subject: Are there in fact fundamental conflicts between the way we approach economics, the way we approach GATT and so forth, and the way Europe and Japan and others are now doing business? Is there in fact a neomercantilistic world in which we are at a significant disadvantage? If so, what sort of broader steps should we take to deal with it?

Mr. COOPER. Are there any questions from the floor?

QUESTION. The question I have is to Mr. Allgeier. I try to sort of play a devil's advocate role rather than present my own view. I will talk about my own view at a later time. I'm very much really dumbstruck by two parallel remarks made by Mr. Allgeier, and Mr. Kim Kihwan in the morning, who used to be a trade negotiator for Korea. He said in the morning—not in the morning, right after lunch—that Korea is doing as fast as Korea can. And Mr. Allgeier said that that is not fast enough.

Just like Mr. Prestowitz was saying, both of them agreed that there should be some kind of compromise solution there—they agree. But the two positions are parallel.

And it will be very, very difficult for Korea—and, again, I want to emphasize that I am talking their position—and Mr. Allgeier admitted that Korea is one of the few developing countries that has voluntarily initiated this liberalization, etcetera. Apparently that didn't get to the USTR or to Congress. From their point of view probably, Korea is not open, Korea is still closed.

So there is a genuine problem, as Mr. Prestowitz said, as to what "open" means. As I understand, in Korea "open" means that as long as there is no license or anything, then anybody can come and compete. And they kept saying, you know, whenever we are open—the Japanese and the United States, it doesn't get it, you know, because the United States simply cannot compete in certain areas. So they tried to do something so that the U.S. sellers or business people may have a more favorable position vis-a-vis the Japanese. The Japanese are taking Korea to the GATT now.

Also Mr. Allgeier mentioned that there is a certain resemblance between Korea and Japan, et cetera. I want to mention a couple of things which the Koreans would say is a very unfair kind of comparison. He mentioned that automobiles and chips and computers, et cetera, which are new kinds of products Korea is trying to sell in the United States, are not really replacing Japanese supply but rather added to the Japanese supply. I do not have the statistical information in these particular areas, but I bet, in terms of U.S. production, this must be very, very tiny.

So again the Koreans would feel that this is trying to penalize Korea's doing it. Korea is doing it because—you know, look at China next to Korea; if Korea does not move, then Korea will completely lose competitiveness, on very labor-intensive products China will dominate.

So that is Korea's way of handling or dealing with that kind of thing, and right now certainly Korea cannot be compared—maybe if Korea stays on what Japan has done, maybe the next ten years or so, then you can legitimately accuse Korea like that. But up to now to say that there is that kind of comparison, resemblance, between Korea and Japan is, the Koreans think, very unfair.

And, furthermore, if you look at the kind of product they are exporting to the United States, that's very different from what Japan does, although the final product may be the same, simply because Korea is not as developed as Japan. And many critical parts and components, in order for Korea to manufacture and export, they have to import. That's a tremendously important difference that any economist or policyplanner should appreciate. There is sort of an intra-industry trade, so that they have to import. That's different from Japan which completely makes everything itself.

One thing which Mr. Hughes mentioned about this manipulation of the exchange rate, et cetera. Korea is not the only country which pegs its currency to the dollar. Many developing countries, which closely deal with the United States, do that simply because it is to their advantage to do so, and nobody can say that you shouldn't do it, or anything like that, because most of their trade is denominated in U.S. dollars. The United States happens to be the

most important country in terms of export and import, so it is very convenient for them to peg the exchange rate to the dollar. The people say the Japanese yen was appreciated, what, about 40 percent, so why not the Korean won?

The thing which they do not look at closely is that the Korean won was pegged to the U.S. dollar, and the U.S. dollar is not a national currency, but international currency. If it was a purely national currency, then it would be much easier to deal with this kind of bilateral trade surplus, or whatever.

But if the Korean won against the U.S. dollar appreciates, then what will happen? Then a small bit of the current account surplus that they had the first time in 1986 will disappear, of course, because they would not be able to export to Japan as much as they can at the current stage, and that would certainly worsen their situation, et cetera, et cetera.

So there is a great dilemma in the case of Korea to deal with this kind of situation.

Mr. COOPER. Let me ask the panel——

QUESTION. Just one very quick, the last point. And all these panelists, although they are very distinguished people, probably read one thing about the U.S. response or U.S. responsibility on what to do about this—and, as you may know very well, this current account deficit that the United States has a counterpart. That is simply that the U.S. gap, the budget deficit, as well as this gap between savings and investment—that gap is reflected in the current account deficit. So unless you do something about that, there is no way you can reduce this current account deficit which the United States is running right now. This is simply reality, and it has to be considered very seriously, that if you don't do anything about this budget deficit, as well as the gap between investment and saving, there is no way you can really handle this.

Mr. COOPER. Let me ask our panelists to respond. Peter?

Mr. ALLGEIER. I'll try to respond briefly on each of these things. I think that your first point is absolutely true, and that is the basis of our disagreement; that is, the relative speed at which Korea can open its economy. When we talk about any particular trade issue, what's really underlying it is this difference in perception as to how fast Korea can move.

I would make two comments on that. From our side, what we see is that there is a lag in perception among the Korean public particularly, and somewhat among the members of the legislature. They continue to see this relationship between the United States and Korea as one in which the United States is this enormously powerful economy that cannot be injured by anything that Korea does, and Korea—I'm overstating it—has a poor, fragile economy that from day to day is wondering where its next meal is coming from. That may have applied in 1953, but it doesn't apply now.

Frankly, I think there is a big lag in Korean perception of how strong Korea is and a misplaced understanding of how powerful we are. And we are working through that difference in perceptions.

On the other side, Americans see the best parts of the Korean economy. We see the products of the most competitive parts of your economy—the automobiles and the steel and the ships and so forth.

Rarely do we see the other side of the economy, the rural economy, where it's much poorer.

So there are some gaps in perception on each side.

Second, as far as the unilateral liberalization—you said that didn't register with the United States—on the contrary, certainly we are aware of it, and in the discussions on the general review of the generalized system of preferences it was made very clear to us by the Korean government the steps they had taken, and we took those fully into account. If you compare the results of the general review, say, Korea versus Taiwan, you will see that we in fact took that into account.

Third, you say when Korea opens, Japan gets the benefits. That is not true. There are instances in which Japan has gotten the benefits. We have heard this so many times from the Korean side. We went back and looked—I think there were thirty-one items that were liberalized by Korea—announced in November of 1983 and implemented in 1984—we looked over the last couple of years to see who got the benefits. In a couple of items Japan got the bulk of the benefits. But in the other items the United States either got the benefits or held its own in terms of taking advantage of the liberalization, so when you look at the figures I don't think that it's quite that clear; you have to look product by product.

Fourth, the comparison with Japan about Korea adding to the Japanese exports to the United States. I recently looked at the figures for semiconductors, for machine tools, and for steel, and in all three instances for the period 1982 to 1986, you'll see that the Japanese share was went up, and the Korean share started small and went up modestly. It is not an enormous amount; they are not taking 50 percent of the market.

But it is incorrect for any country to say, "we are only taking 3 percent of the U.S. market, how can we possibly hurt"—when that 3 percent is on top of somebody else's share and when you have 60 countries saying, "we, only take 2 percent, what's the problem?" [Laughter.]

Well, we tend to sum those—and that's the problem.

And then the next-to-the-last thing being Korea cannot be compared with Japan. As somebody who cares about the bilateral relationship between the United States and Korea, I hope that you won't be compared with Japan. And that is why I am making the suggestion that we move fast now, because nobody wants to be put in that same category as Japan, at least in terms of Japan's image here in the United States. But it will happen a lot, lot faster than 5 to 10 years if things don't change.

Finally, you said we omitted the discussion about our own budget problems, the gap between savings and investment. That's true, and we are dealing with that, and that is why the Gephardt approach is not an appropriate approach; it assumes that trade policy can change things a lot more than it really can.

Mr. COOPER. Kent, would you like to respond? I think you were mentioned during the question.

Mr. HUGHES. I do think the savings-investment imbalance is widely understood in the Congress. The mainstream economists have focused on the fiscal deficit; in the case of the United States,

because it causes the saving-and-investment imbalance, it is related to our budget deficit.

What is going on in part now is an attempt to bring these deficits down together with reasonable speed, so that the effort appears to be somewhere between 1 and 2 percent of GNP in terms of reducing the budget deficit in the hope that the same kind of response would take place on the trade deficit side. To do that you've got to start taking account of the lags and so forth between when a currency starts to change and when you actually find some difference in the flow of products.

In terms of the exchange rate, which, of course, is a vehicle for translating these savings and investment imbalances into trade and capital flows, the problem would really parallel what Peter said in terms of taking only 2 percent of the market. It's true one country might find it advantageous to tie its currency to the dollar, but if, as we eliminate the savings and investment imbalance in this country, the exchange rate doesn't lead to a change in the trading relationship, then something else, some other path will have to be found.

And also the debate here is not purely on a macro level. People are concerned about the size of the trade deficit and the prospect of being a trillion-dollar debtor at the end of the decade; but they are also concerned about exactly what we are trading, and the fact that increasingly it appears to challenge our own vision of a high-tech future.

Mr. COOPER. Clyde.

Mr. PRESTOWITZ. One other comment. Since I've staked out a heretical position, I'll go all the way. But I will preface that by saying that I was at a meeting of eminent economists yesterday and I posed the same question, and I did not get a denial. The savings and investment argument is always that because the United States has not sufficient savings that that inevitably results in a trade deficit. Well, that's an equation; an equation has two sides. The assumption that everyone makes is that the only actionable side of the equation is the lefthand side, but in logic that doesn't hold; the equation can work both ways.

Now, the Joint Economic Committee has a model. The Joint Economic Committee model says that if the U.S. unemployment rate drops by 1 percent, that the U.S. budget deficit drops by I think it's something like $40 billion. Now, the rule of thumb is that a billion dollars worth of exports is 30,000 jobs. So if you reduce exports, or imports, sufficiently to let's say reduce unemployment in the United States by however many million jobs it is, then you automatically get a higher level of economic activity in the states and higher levels of savings and higher levels of taxation, and you reduce the budget deficit.

So it seems to me that logically there is no reason to believe that this assumption we are all making about the U.S. savings rate is correct. The equation may be operated the other way, and it may be that Gephardt is right.

QUESTION. How does the domestic political agenda in Korea affect the degree of pressure you will exert on trade issues over the next year or so, or does it affect it? And if it does affect it, is that a

constraint on your ability to influence the evolution of trade legislation?

Mr. COOPER. Did everybody hear that question?

Mr. ALLGEIER. We are aware of the political situation in Korea. I think that it affects our negotiations less by changing the attitude we have as we walk to the negotiating table than it does in the negotiations when we are talking about these things and we get a sense of how this particular issue plays, what interests it affects in Korea. And we don't have sort of a rule of thumb, but in any negotiation part of it is to understand what constraints the other side has, what constraints you have, your different objectives, and try to work something that doesn't do enormous damage to each side's constraints and objectives.

So it plays like that, like almost any other factor that the negotiators bring to the table.

But certainly there's no sense that it's hands off Korea this year, and we hope that the Koreans understand that we have our own political problems and we try to make them understand that.

QUESTION. Let me ask the panel if an additional 30-percent rise in the yen would make the Korean-United States bilateral deficit disappear.

We are currently pursuing a policy, I would gather—the Treasury Department is supporting the dollar against the yen so it's not going to go much below 150. That's the current government policy. If we abandon that policy and let the yen rise some more, which is what it seems to be trying to do, wouldn't that have the effect of correcting the bilateral imbalance?

Mr. HUGHES. It's an awfully roundabout hope. If in fact the Japanese market is as closed as it appears. I think your hypothesis is that as the yen goes up, the Japanese buy more from the Koreans, and the Koreans buy more machine tools from us, and so forth.

Mr. ALLGEIER. But the Koreans also sell to the United States instead of Japan selling to the United States.

QUESTION. This would solve the problem if they started buying from us instead of from Japan; both the deficits would go down.

Mr. ALLGEIER. Their sales to us would increase; there would be diversion, trade diversion from a Japanese supplier to a Korean supplier.

Mr. HUGHES. They would rush in where the Japanese could no longer tread.

Mr. PRESTOWITZ. You also assume that we can make the things that they now buy from the Japanese, but much of what the Japanese make we no longer make. So it doesn't matter what the price is.

QUESTION. I guess I'd like to contribute to mutual understanding, and point out a few things that should not be left uncommented on. First, I'd like to make a comment on Mr. Prestowitz's remarks. I wouldn't really go into every detail, but he treated this deficit as if it is entirely dependent upon the openness of the market. And I don't think that is really the case. It more or less depends on the relative growth rate and the economic performance, and the difference in the economic performance between the two is the biggest factor.

I remember, I think, some time back even Treasury or Commerce said even if Japan eliminates all the trade barriers and makes the economy completely open, it would not really eliminate the entire United States-Japanese bilateral deficit. So let me just sort of as an economist make that comment.

And he also made the comment that by protecting U.S. industry you could reduce the unemployment rate in this country. I think I would really challenge you to try that and see if it really works. Close the U.S. market entirely and try to solve the unemployment problem. I think that is something for us all to think about.

That really brings me to my comment on Mr. Allgeier's remarks, that is, that the United States is a very large and important market for Korean products, and it is the largest market. But let me point out that if you look at the historical data, the percentage of Korean products coming into this country of all Korean exports were as high as 50 percent, more than 50 percent, in the latter part of the 1960's. It declined steadily to 26 percent until '81. There was a tremendous diversification, and then it edged up again to the present level of 40.

I think you can verify this and this is a fact.

Now, why did it happen? Why does this coincide with the rapid expansion of the U.S. deficit? That's the point I think we should really think about. It takes two to tango. Korea would not be able to run this trade surplus unless there is a market, unless there is a demand in this country.

So what was the cause that Korea came to be dependent so much on this country? Over-valuation of the dollar and under-valuation of the yen. Relative high performance of this country compared to the other countries. And, in Korea's case, the collapse of the Middle Eastern market as the oil revenue into this country declined. And these are the global factors not within the control of the Korean economy. Korea is a very vulnerable economy. Whatever happens outside the economy really determines the performance of the country. Even if there is a group of, say, brilliant economists gathered together in the background of government who have devised a brilliant economic plan and strategy to penetrate this country, they won't be able to unless it is somehow accommodated, unless there is a demand.

I think it is very easy for us to forget, when we talk about Japan, when we talk about Korea, when we talk about Taiwan, we forget this side.

Mr. COOPER. Our time is running short. Let me ask the panelists to respond to your comments.

QUESTION. Could I make one last comment?

Mr. COOPER. Yes.

QUESTION. Localization has become a dirty word, I think, but it really shouldn't be. Insofar as some industries can be economically viable in the country, but there are some external factors that prevent that industry from springing up, then I think there is an economic justification that really justifies a certain effort on the part of the government to really nudge this industry. And we really can abuse this argument and apply it to many countries. I think we did that in the 1970's with the heavy chemical industrialization.

So that's a few comments.

Mr. PRESTOWITZ. Well, I'll make two quick comments. The study that you refer to about if Japan opened its market what would happen—in fact, the Commerce Department did do a study in 1982, at which time the trade deficit with Japan was about $15 billion, and concluded that if Japan opened—and I use the term "open" in the American sense, that is, if it had strict anti-trust, you got rid of kaidetsu [phonetic] relationships, you had an open market a la the United States—that the trade deficit would be more than wiped out. Now, subsequently the Institute for International Economics here in town, run by one C. Fred Bergstrom, did a study. They did several things in their study. One thing that they did, of course, was to critique the Commerce Department numbers; they came out with a figure of about $5 to $8 billion. One has to keep in mind that that study was funded by the Japanese.

It's very easy to go down a list of products and come up with some pretty big numbers. The question is what do you mean by "open"? That's where it all hangs. If you are talking about open just in terms of formal liberalization—getting rid of a quota, removing a tariff—that won't do it. It didn't do it in Japan, it won't do it in Korea. If you are talking about—and here's a second point—I think you just confirmed my thesis, because you said that localization is good. But localization is the antithesis—I'm not saying it's bad, I'm not condemning it; I'm just saying that theoretically it is the antithesis of comparative advantage economics; it is Schumpeter in economics.

VOICE. That's not true.

Mr. PRESTOWITZ. Well, it is—and you simply can't have free trade and open markets if you carve out a particular market and say, well, this one we have to have, for whatever reason. You may have to have it; I'm not saying you can't have it. I'm just saying that if you carve these out and say this one we have to have, we think we can make it good, and we are going to subsidize it and push it and aid it to make it good, you can't have free trade in that market. And if you have a trading partner who happens to be good in that product, then he will not achieve the benefit of his comparative advantage in that product. And you are engaging in adversarial trade. And this is really where the whole debate lies.

Mr. COOPER. Peter, do you want to comment?

Mr. ALLGEIER. A couple of things. In terms of your identification of the factors that have caused Korea to export so much to the United States, they are correct and I wouldn't dispute those. My discussion didn't get into the question of why Korea got to this level of dependence on the U.S. market; I was just accepting that as a given, of a factor that is here, at least for the next couple of years, several years, and appears likely to continue. And so how do we deal with that in terms of our trade diplomacy?

As for the question on localization in terms of classic economic theory as taught in this country, there is an infant-industry argument that can be made. It is much more narrowly circumscribed than is the practice of the countries of the world. And one of the things, frankly, that the United States has been lax on is insisting that countries that claim that they ultimately have a comparative advantage in this particular industry, if they only will give it a few years and a little bit of help—we have not really insisted that they

justify that and demonstrate that in fact they do have a long-term comparative advantage, because that is the only basis for the infant-industry justification in economic theory. My hope is that you will see us being much more active in the GATT, where there is an infant-industry provision and which only seven countries have used over the history of the GATT. And there's only one pending use of it.

So that "localization" may not be a dirty word, but "infant industry," is a term that is being used very, very loosely in international trade today.

QUESTION. Mr. Chairman, just a very quick comment. I think this exchange of discussion between panelists and audience reminds me—I am speaking as a political scientist rather than an economist—that perhaps we are talking about free trade in theory or in abstract, but to me trade is a—a managerial model, it seems to me, is more close to reality. And the United States and Korea being allies. And Mr. Allgeier mentioned earlier that South Korea must be encouraged to go through the country market, which in a way is a kind of trade policy manipulation of the problems that exist bilaterally between the United States and Korea.

So my question is: What can South Korea and the United States do vis-a-vis Japan? I think that President Reagan's latest announcement, it seems to me is really putting the finger on the trade deficit question, which is very serious. And maybe South Korea and the United States as allies can do it jointly instead of playing a zero-sum game, perhaps a variable-sum game, in order to protect mutual interests. Do you have any suggestion, Mr. Allgeier, as to what the United States and South Korea can do vis-a-vis Japan?

Mr. ALLGEIER. Well, certainly we, Korea, and every other country in the Pacific Rim have an interest in opening up the Japanese economy.

Mr. PRESTOWITZ. Wait a minute, Peter, the Japanese say their economy is open. [Laughter.]

They say just what all these people say. I've heard this in Japan; I've heard that Japan is a vulnerable economy; I've heard that localization is good—the Japanese don't call it "localization," they call it "industrial policy." I've heard that the U.S. growth rate is too high, I've heard that the U.S. savings rate is not high enough, I've heard that the dollar is overvalued. I've heard all these from Japan, and the Japanese say their market is completely open.

Now, who's to say their market is not open? They don't have high tariffs, their tariff level is the lowest in the world. They don't have any quotas to speak of, just a few, a few agricultural quotas, less than the French have. You say their market is not open? In what way is their market not open?

Mr. ALLGEIER. Well, obviously that's a rhetorical question. But it is rather strange that the best traders in the world throughout the Pacific Rim——

Mr. PRESTOWITZ. Wait a minute, the Japanese are the best traders in the world.

Mr. ALLGEIER. We're trying to change that. [Laughter.]

But the one thing that does bother me in the question is that it's all too easy for other countries with whom we have bilateral trade

problems to bring up the Japanese example and say Japan is where our joint problem is and let's work on that and we can sort of ignore our own bilateral problems. Now, I don't know if you meant for us to ignore the bilateral problem, but we acknowledge that we have a problem with Japan, we have a joint problem with Japan, that a coordinated approach probably would be better than a bunch of uncoordinated approaches—but we still have to sit across the table from the Korean government and solve the real problems that we have with Korea.

Mr. COOPER. Our time is up. I want to thank you very much for coming, and I especially want to thank our panelists for a very, very stimulating discussion. [Applause.]

[The workshop recessed at 5:45 p.m.]

# KOREA AND AMERICA IN THE 1990's

TUESDAY, MARCH 31, 1987

HOUSE OF REPRESENTATIVES, COMMITTEE ON WAYS AND MEANS, THE WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS, AND THE CONGRESSIONAL RESEARCH SERVICE,

*Washington, DC.*

The workshop met at 7:40 p.m., in the Woodrow Wilson Center for International Scholars, the Smithsonian Institution, James H. Billington, Director, the Wilson Center, host.

Moderator: Ronald A. Morse, Secretary, Asia Program, the Wilson Center.

Speakers: Robert A. Scalapino, Director, Institute of East Asian Studies, University of California, Berkeley; Hon. Kyung-Won Kim, Ambassador of the Republic of Korea to the United States; and Hon. Marcy Kaptur, U.S. Representative from Ohio.

This program is jointly sponsored by the Asia Program of the Woodrow Wilson International Center for Scholars, the U.S. House of Representatives Committee on Ways and Means, and the Congressional Research Service of the Library of Congress. This evening discussion is made possible by a grant from the Korea Research Foundation.

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Pharis J. Harvey, North American Coalition for Human Rights in Korea.
In-Kie Hong, President, Daewoo International America Corporation.
Kent Hughes, Staff Director, House Foreign Affairs Subcommittee on International Economic Policy and Trade.
William H. Hurt, Chairman of the Board, Capital Strategy Research Group.
Dayna Hutchings, Wharton Econometrics.
Jai-Ryong Jang, Counselor, Embassy of Korea.
E.G. Jefferson, Chairman of the Finance Committee, E.I. du Pont de Nemours & Company.
Grace Kahng, McNeil-Lehrer News Hour.
Jiro Kamimura, General Manager, Mitsubishi International Corporation.
Byung-Moo Kim, Washington Bureau Chief, The Hankook Ilbo.
Duk-Choong Kim, Director, Research Institute for Economics and Business, Sokang University.
In-June Kim, Department of Economics, Dartmouth College.
Kihwan Kim, President, The Ilhae Institute.
Kyong-Dong Kim, Professor of Sociology, Seoul National University, Fellow, The Wilson Center.
Seung H. Kim, director, Korea and Northeast Asia Program, Center for Strategic and International Studies.
Austin Kiplinger, Washington, D.C.
Don Kirk, Special Projects Editor, USA Today.
Shinzo Kobori, Senior Vice President, C. Itch & Co. (America), Inc.
Takeshi Kondo, C. Itch & Co. (America), Inc.
Mindy L. Kotler, President, Search Associates, Inc.
Nicholas S. Lakas, Executive Director, U.S. Korea Society, Inc.
Donald S. MacDonald, Research Professor of Korea Studies, Georgetown University, School of Foreign Service.

Dennis McNamara, Sociology Department, Georgetown University.

Robert J. Meyers, President, Carnegie Council on Ethics and International Affairs.

Seymour S. Miller, Vice Chairman, Caltex Petroleum Corporation.

Larry Niksch, Specialist in Asian Affairs, Congressional Research Service, Library of Congress.

Dan Oberdorfer, The Washington Post.

Eul Y. Park, Consultant, World Bank.

Peter A. Petri, Department of Economics, Brandeis University.

Thomas E. Petri, U.S. Representative (Rep.-Wisc.).

Frank Phifer, Professional Staff Member, House Ways and Means Committee.

Daryl Plunk, Policy Analyst, The Heritage Foundation.

Earnest Porta, Special Assistant, Asia Program, The Wilson Center.

Clyde Prestowitz, Fellow, The Wilson Center.

Stan Roth, Staff Director, House Foreign Affairs Subcommittee on Asian and Pacific Affairs.

Jefferson Seabright, Legislative Assistant, Office of Senator Rockefeller.

Linda Silver, Korea Economic Institute.

John Sloboda, Washington, D.C.

Jack D. Sparks, Chairman of the Board, President and Chief Executive Officer, Whirlpool Corporation.

David Steinberg, Mansfield Center.

Richard Stillwell, Washington, D.C.

Joun-Yung Sun, Minister, Embassy of Korea.

Nat Thayer, Johns Hopkins University, School of Advanced International Studies.

Howard Tucker, Potomac Asset Management, Inc.

William Watts, President, Potomac Associates.

Nathan White, National Defense University.

Gregory F.T. Winn, Division Chief, Private Sector, USIA.

Jon Yellin, Assistant Director for Administration and Finance, The Wilson Center.

John Yochelson, Center for Strategic and International Studies.

Jong Keun You, Washington, D.C.

Whan Kihl Young, Political Science Department, Iowa State University.

Mr. MORSE. It is a pleasure to welcome all of you here this evening for what is the last phase of a day-long event. Some of you—most of you, actually—have been with us the whole day, some of you haven't. We had a series of very informative and active discussions with the Congressional Research Service. This meeting is sponsored—the whole day's events are sponsored jointly by the Congressional Research Service, The Wilson Center and the House Ways and Means Trade Subcommittee.

We've done this before twice, once on Japan and once on the Philippines. This is the third time we have done it with these organizations, and we find that it's very useful.

Tonight's activities are being recorded here. The whole event, all of today's activities, will be published as a committee print.

When you ask questions, you should identify yourselves for the speakers, but none of you will be identified in the record. The speakers, however, will be identified. If you ask questions and they respond and it's taken down, your name won't be included in the question unless you want it to be, in which case you let us know and we will be happy to include you.

It's a pleasure to introduce the three speakers we have this evening, because in some ways, to me, they represent three very positive aspects of United States-Korean relations.

Bob Scalapino, I think, immediately on your left and my right, needs no introductiion. Bob Scalapino has been sort of the dean of not only Japanese studies at Berkeley but also one of the people who has trained almost everybody in Korea that's in international relations as well as people in this country. He is the head of the Institute of East Asian Studies at Berkeley which has grown over the years to be one of the major centers for relations with the Pacific Basin.

He, himself, actually—I won't say how long ago I used to sit in his classes at Berkeley where I graduated from and got my first training on East Asia from him. And I know there are lots of other people that have, too. So it's a real pleasure to have him here at The Wilson Center.

I never thought I would have the opportunity to introduce you when I used to be sitting there listening to these words of wisdom that used to come out.

Bob Scalapino, I think, as many of you know—there's nothing that he writes or says that somebody doesn't find a real gem in, in some ways or other. There's always an idea there that is very significant and I think he has shaped a lot of people's lives in this regard.

So I am going to let him lead off with the speaking, then I will introduce Ambassador Kim and Congresswoman Marcy Kaptur in that order. And after they are finished speaking, then we will open it up for discussion.

Bob?

**STATEMENT OF ROBERT A. SCALAPINO, DIRECTOR, INSTITUTE OF EAST ASIAN STUDIES, UNIVERSITY OF CALIFORNIA, BERKELEY**

Mr. SCALAPINO. Thank you, Ron. I much appreciate your kind remarks. As I was reflecting on the events of today and particularly the fairly sharp divergence of opinion this afternoon, I kept thinking, "How am I going to reconcile this group?" I felt as if I were stepping into a den of lions.

This reminds me of a story recently told me. The time was in the early Christian era. The place was the Coliseum in Rome. A weak, anemic Christian had been chosen for a very large lion, with the Emperor Nero in attendance. Everyone thought, "This is going to be a very quick performance." The lion came out roaring, and the Christian followed. He went up to the lion and whispered in the lion's ear. Then, nothing happened. The lion just sat there, so the Christian was freed. The crowd was astonished. The emperor asked the Christian, "How did you do it? What did you say to that lion?"

The Christian said, "I just told him, 'You know, after dinner, you're going to have to make a speech.' "

That's my penalty for having had dinner with you tonight.

Let me start by seeking to place the United States-Korean relationship, present and future, in a broad perspective. It would be foolish to make detailed predictions about any aspect of our bilateral relations. This is an extraordinarily fluid period. In my view, during the next three decades, we shall witness changes that will be equivalent to those of the previous three centuries. We are on the threshold of a new phase of the Industrial Revolution, one which will produce truly dramatic results in fields like biogenetics, telecommunications, and space, to mention only a few. The era immediately ahead is going to change the entire character of human life.

One of the supreme challenges for every government is whether they can adjust the pace of decisionmaking, including very basic policies relating to economic structure and political institutions so that these accord with fast-moving socioeconomic developments. Given this necessity, the customary operations of the modern democratic state may not suffice. In democracies, there is a certain timing of action that relates to preparing the people for the steps to be taken and within the government itself, ironing out differences of views, and finally coming up with compromise solutions.

We have so little time, however, given the speed at which events move. The crisis today between ourselves and Japan and the looming crisis with Korea and other so-called newly industrializing countries (NICs) stems in part from this situation. The time to adjust policies and to make structural changes is very, very short for all parties concerned.

Two problems loom up in the Pacific-Asian region in the period ahead—Problems that deeply affect Korean along with most other countries in the area. One lies in the economic arena. To put it simply, what economic strategy will be acceptable and feasible for the period ahead?

We have talked extensively today about the success of Korea, and with good reason. But what strategy for the future will be most effective in terms of Korea's relationship with the United States and the other advanced industrial societies? Can an effective Korean economic strategy be found that is also harmonious with our mutual relations?

The second problem is political, and I would put it this way: How will the contest between the need for stability and the demands for political openness be worked out in a society like Korea?

It is clear that every society in Asia needs a degree of stability; otherwise, development is impossible. On the other hand, the very socioeconomic revolution that has been taking place has bred new elites. The term "middle-class" is misleading since it connotes the Western commercial-industrial community. The new elites that are emerging in Korea may partake of this class although it is rarely in the vanguard. More centrally involved are the students and intellectuals, including journalists and religious figures, as well as various professionals. They share higher education and greater affluence as well as more extensive knowledge about the world around them. Thus, they want greater political participation in one

form or another and a more responsible, "moral" government. They want to be a part of the political process.

This contest between the need for stability and the desire for greater political openness and participation is at the heart of the political problem in Korea—but by no means only in Korea. It is the issue dominating contemporary Asia, cutting across ideological and political lines. As we have seen, it is also an issue in China, and it is clearly a concern throughout much of the ASEAN community as well as in the South Asian subcontinent.

It would be comforting to say that we of the Western World—Americans and Europeans—have no basic political problems in the period ahead, but I disagree. While I personally am a staunch supporter of parliamentarism, considering myself a liberal in this sense, I foresee an increasing number of problems as we move into the 21st century, problems as to how we preserve a free society while at the same time inducing our various interest groups to practice responsibility. Total freedom accompanied by an absence of responsibility is a prescription for disaster.

This is already a major problem for advanced industrial societies, especially the United States. The lack of civic consciousness on the part of our special interest groups, their incapacity or unwillingness to see beyond a self-centered set of interests or to acknowledge the interests of the community-at-large threatens the welfare of all. A case in point is our media, so powerful in contemporary American society. They demand total freedom but they do not want to accept responsibility for their actions. Even though they have become virtually as powerful as the government, at no point are they subjected to an electorate or held accountable with respect to professionalism and balance. It is somehow assumed that they will either be self-regulating or that no matter what excesses—whether of sensationalism, superficiality or bias—somehow these will be corrected in the long run. This problem can only grow, raising very fundamental issues about the governability of democratic societies in the years ahead. I briefly mention this issue in order to indicate that the problems of democracy are by no means confined to those societies seeking to emerge from authoritarianism.

Let me now focus specifically on the issues most likely to influence future American-Korean relations, commencing with those in the political arena. My own view is that there will be no unilineal progression in Korea toward a pluralistic parliamentary system. I think the road ahead is likely to be rocky with ups and downs, also with periodic crises, but with an overall trend in the direction of civilization and greater openness. Further, my guess is that the end-product will not be pure Western-style democracy, but a political system that accords with Korean culture both in certain traditional aspects and as it is evolving.

Most of the pluralist societies of Asia have gravitated toward a dominant party system. This is even true of Japan, although it has preserved a dominant party system through wholly democratic means. Political rights and the institutional safeguards for democracy are as complete in Japan as in any society. An extensive Bill of Rights exists together with the fullest political competition. Yet political power has not been transferred in Japan through the electoral process for many decades. Long ago, I defined Japanese poli-

tics as a one-and-a-half party system. There is only one party that has known power, and all of the others have been oppositionists.

I rather suspect this will represent the near future of most of the pluralist societies of Asia. A dominant party system will triumph, with the issue being the extent to which that dominance is based upon serving the electorate, upon a public ratification of the legitimacy of the dominant party, and the extent to which it is due to coercion or manipulation. Here lies a central political issue for much of Asia in the years ahead, quite possibly including the Republic of Korea.

We, in the United States, will continue to hope that Asian societies move toward political openness, with as much protection of human rights as possible. Indeed, our commitment to this cause is greater than that of all other major powers. For example, the Japanese are not terribly interested in doing missionary work for democracy. They are prepared to interact with diverse cultures without demanding that they adhere to certain values. Americans, on the other hand, have always demanded a moral foundation for our foreign policy. This has made us unique. Like the Japanese, the West Europeans have placed relatively little emphasis upon normative considerations. They have been much more concerned with the balance of power. It took a European named Henry Kissinger to bring that concept to Washington some years ago.

My point is this: we will continue to confront a dilemma with respect to societies like Korea. Many of our citizens want Koreans to be more like us politically. They will want to support those who call for liberalism. We all understand that and, in some respects, we all underwrite such aspirations. Yet, the hazards are clear. How far should we go in intervening—either by word or action in the internal politics of another country? To what extent can we afford to be involved in the political process of another state, and what form should such intervention take?

The arguments on behalf of private, quiet, diplomacy versus those on behalf of a public stance that puushes hard are well known. My own belief is that we should make it very clear that American public congressional support depends upon the actions of given governments with respect to human rights. We generally make greater progress, in my view, by doing this quietly and privately. But there are times when our voice must be heard more publicly, more loudly. In any case, it is within this arena that a principal political issue between the United States and the ROK will continue to exist.

We are all hopeful that in the next 18 months, President Chum is going to turn out to be the first Korean president to step down peacefully through an electoral process. We are also hopeful that the combination of openness and fair, competitive elections will be such that the successor government will have maximum legitimacy with the Korean people.

This is an extraordinarily delicate period for Korea, and I have often said something that was emphasized this afternoon—namely, one of the difficulties is that, within Korean culture, there is a very limited tolerance for opposition. Yet a democratic system cannot be successfully operated without such tolerance. This problem cuts across all political lines in Korea. It is true of the government but

it is also true of the opposition. The capacity to compromise, the willingness and ability to work with one's opponents is something that Western governments learned over many, many decades—indeed, centuries. It is being thrust upon Asia rapidly, and in the face of the fact that governance in Asian societies has been based upon the principle of consensus rather than majority rule. It is thus difficult to trust those who choose to remain outside the consensus. The idea of protecting minority rights and accepting difference is a part of the democratization process, but it is not easily assimilated, given Asia's traditional values.

Let me turn to the economic arena. I think it is very likely that, as with Japan, United States-Korean economic relations will get worse before they get better. If there was a matter that bothered me this aternoon it was that my fellow Americans did not always emphasize what I regard as an absolutely cardinal point—namely, our seeming inability to get our own house in order, our unwillingness, for example, to handle our budget deficit and related problems.

I am not an economist, but I strongly believe that there can be no basic solutions to the United States-Japanese, United States-Korean, or United States-newly industrializating countries economic problems unless we seriously tackle our domestic ills. This will require both cutting expenditures and raising taxes. Unfortunately, that is a bullet that not many people have yet been willing to bite.

Regrettably, in democratic societies, it is the short-term gains that pay off, not the long-term visions. But unless both of our major political parties are prepared to tackle this seriously, the gimmickry with which we have surrounded the domestic economic issues up to this point will be to little avail.

This is by way of saying that I think there is enough blame to go around on all sides. I am not for a moment exempting Japan or Korea from their share of responsibility. You cannot increase imports into the United States by 25 or 30 percent per annum in some categories without expecting a backlash. Products cannot be sold abroad at a lower price than at home in an effort to capture the market or patents infringed without legitimate protests. These are not responsible policies, and political repercussions are to be expected.

There has been little effort in Asia, it seems to me, to understand the inevitable political and psychological repercussions of such policies until it is too late. Then the bashing has commenced and a much more difficult problem has been created.

In the middle to long term, however, I am cautiously optimistic. I believe that the Pacific-Asian region is, generally speaking, going to be a region that shows strong to satisfactory growth. I also believe that we shall be compelled to move toward regional and international agreements, forced to find new approaches in the post-Breton Woods era with respect to monetary policies.

We cannot live satisfactorily in a quasi-anarchistic world. Sooner or later, both our people and our leaders will recognize this and begin to move us toward a more effective international system. We are coming to the end of an era of dependence upon ad hoc summitry. Ad hoc summitry is all right for brief periods of time, but it

is not a long-range solution to the very complicated age into which we are entering.

Let me say a few words about foreign policy. I am relatively optimistic that we shall avoid a major war both in Asia and in the world. Both the Soviet Union and the United States know the costs of war, know also the costs of the present arms race. Not without great difficulties and interludes of crisis, we are moving toward meaningful arms control.

To speak in more regional terms, I believe that we are also going to enter a period when North-South Korean relations will be marked by some degree of dialogue, and ultimately economic and cultural intercourse. I would expect that in the next decade, North Korea will "turn out" more than in the past and cease being, along with Albania, one of the most isolated societies in the world. Out of sheer necessity, North Koreans will seek the science and technology of advanced nations. Indeed, we have already seen many signs that they want to do this, although the cost for them—political as well as economic—constitutes a difficult problem. Any people that are extremely isolated and heavily indoctrinated can be severely disillusioned when they see the real world.

Pyongyang is surly watching some of the problems of Beijing in this connection. "Spiritual pollution" will inevitably emerge in North Korea at some point in the process of entering the global scene. This must worry people like Kim Il Sung and even his son. But it is destined to come. North Korea cannot continue to decline into obsolescence, into increased economic difficulties. Moreover, there are the pressures that the allies of the DPRK are putting on it in connection with events like the Olympics. The present course risks North Korea's security. Thus, modernization and internationalization will ultimately be put as a security issue. In sum, we are going to see some loosening of North Korea policies—the only question being timing and degree.

Meanwhile, at some point, the United States will reconsider its security relations with South Korea, not in the sense of abandoning these, but with respect to the precise manner in which they are fulfilled.

It is entirely possible that in the 1990's, when the present South Korean Defense Plan is fulfilled, it will be determined that South Korean ground forces suffice for defense and the Guam declaration will come into effect. In my view, however, as long as South Korea keeps its fundamental commitments to both political and economc reform, we shall keep our contract with respect to our security commitment.

Let me conclude on a more general note. What some people have called the era of "Pax Americana" has ended. Our overwhelming responsibilities for global and regional security together with massive aid programs like the Marshall Plan are no longer feasible—or necessary. This era is over and our allies must take account of this. Indeed, the very word "ally" probably needs redefinition. In broad terms, on the international front we are moving from an era of alliances to one of alignments. This is to say, the tight, all-encompassing relationships of the post-World War II period in which we made absolute commitments and our allies made pledges of political allegiance is over. Now we are entering a much more complex

era in which we make conditional commitments, and those associated with us show a greater degree of political independence.

The management of alignments is a far more complicated matter than the management of alliances, because its success hinges to a much greater extent upon consultation, compromise, and the kind of close working relationship between "equals" that is often difficult to achieve and maintain. It represents a very great challenge.

One should also note that despite—or perhaps because of—the growth of interdependence, we are witnessing the resurgence of nationalism in diverse forms, and in many countries. In Korea, nationalism is taking new forms, some of them anti-American. We are witnessing a similar phenomenon in Japan. And in the United States also, nationalism has been on the rise. I do not regard this as something to be regretted. A pride in one's country, a sense of patriotism is vitally important to the strength of a nation. The American people have a strong need to revitalize their commitment to their country after the negativism and destructiveness of the 1960's and 1970's. They must also spend much more time thinking about and resolving local problems. Those represent the principal concerns of the average American today, understandably, given the difficulties of urban life including crime, education, and all of the other things that are in need of reform. Moreover, this will continue in the decade ahead.

It is thus going to be vitally important for our leaders to balance out our international commitments and our domestic necessities. We can only do that responsibly, in my view, if nations aligned with us provide assistance. That is to say, they have to bear an increased share of responsibility both for security and for the international economic order.

It is in this respect that you will determine—and by "you," I mean Koreans, Japanese, and Chinese—the degree of internationalism which the United States can maintain. The responsibility does not lie wholly with us. Your actions, your policies, the way in which you approach our mutual problems is going to have a great deal to do with the question of whether the American people will support the degree of internationalism that is necessary for a stable world.

Mr. MORSE. I think if Bob Scalapino has made a valuable contribution in training all of the experts that Berkeley has turned out over the years to better relations with the Pacific Basin, I think Korea has made its contribution in presenting people like Ambassador Kyung-Won Kim out of their diplomatic corps to represent them in countries like the United States.

Ambassador Kim has been trained at Williams College as well as Seoul National University. He has a Ph.D. in Political Science from Harvard University, where he was a Teaching Fellow in the Department of Government. He taught at York University, in Toronto; New York University and at Korea [phonetic] University.

He then left his academic career when he was appointed Special Assistant to the President for International Affairs. He continued to hold foreign policy positions. He became Secretary General to President Chun Do-Won [phonetic], a permanent observer to the Republic of Korea at the United Nations and served there until November 1985 when he was appointed to his present position.

He has written a book, called, *Revolution And The International System.* And I think a number of people in this room—Kim Kow-Dung [phonetic], who was a Fellow here at The Wilson Center—a number of distinguished Koreans have made a valuable contribution not only to American life but also to the mutual understanding between the two countries.

And I think at a place, like where Woodrow Wilson symbolizes the sort of interaction of scholarship and the world of public affairs, it's a pleasure to welcome Ambassador Kim.

**STATEMENT OF HON. KYUNG-WON KIM, AMBASSADOR OF THE REPUBLIC OF KOREA TO THE UNITED STATES**

Ambassador KYUNG-WON KIM. Thank you. Normally, I would have started by thanking the organizers of the conference for inviting me to speak and saying what an honor it is, indeed, to be here and have this opportunity to share my thoughts with you. Tonight, I am going to add a little discordant note to that. I am going to have to protest to the organizers that they placed me right after Bob Scalapino's brilliant performance—[audio interference].

I was about to say Professor Scalapino asked, as we all I'm sure felt, very relevant, most important questions that need to be asked, and identified issues and suggested scenarios as to what is likely to occur.

And I was thinking, if it is the job of an intellectual to ask relevant questions and define them as sharply as one can and suggest alternative answers or responses to those questions, the job of an ambassador or diplomat must be to do his best to try to brush them under the rug. And that's what exactly I intend to do. So, don't look for lucidity or clarity in my presentation.

I am helped in this regard by the way that the topic has been defined for tonight's panel. I understand we are discussing United States-Korea relations in the 1990's and one thing that is wonderful about the future is that you can say all kinds of wonderful things about it without having to produce any hard evidence to support your contentions.

So, I am going to just take a leap of faith and launch ahead and say all kinds of wild, widely optimistic things that I can come up with about the 1990's. I will make some assumptions as to what is going to happen in this country, what's going to happen in Korea, and then try to see what the nature of our bilateral relationship is going to be like in the 1990's.

First, with regard to the United States, let me start with a very bold and unsubstantiated forecast, namely, that the number one issue that seems to be on the minds of everybody and that I'm sure was discussed during the day's proceedings the trade deficit that the United States has today in the order of $170 billion is going to go down. It will probably not go down as much as it is expected to by some optimists, $10 million annually, but I would dare to forecast that it is more likely to go down than go up. And by the 1990's—sometime by the 1990's, say, 1990 or 1992, or what-have-you, it will go probably below $100 billion. In other words, it will become a manageable deficit. It will not disappear right away, but

I think it is reasonable to assume that the trade deficit, the magnitude of it will be considerably reduced by the 1990's.

What it means in terms of politics is, I think, that if politicians are thinking on running on a protectionist stand, program or platform, they had better do it now because by the 1990's, the U.S. politics will be in the new era—a new post-protectionist era, so to speak. The American people we know have gone through a great deal. There is somehow always a pattern in which there is a crisis, and there are different estimates as to the magnitude of the crisis—some tend to be more pessimistic than others but, nevertheless, it becomes the focus of public attention all over the country.

And somehow, without anybody having forecast this, the American people—this nation—this great country moves out of that crisis, or through it, or whatever—beyond it, and then begins to react to it.

So, after Vietnam, you get post-Vietnam syndrome and politics of reaction to that Vietnam experience. It happened after Watergate, too, in a sense. And I would dare to predict that after the current concern with the trade imbalance—trade deficit has become—I almost said a matter of historical memory but then I realized that it probably isn't. It would be an exaggeration to use an expression like that, but I would think that it would be reasonable to assume that the U.S. public issues of the 1990's will not include that of protectionism.

In foreign policy I am afraid that my crystal ball does not show any sign that there is going to be any fundamental change in the nature of challenges the United States will continue to face in the 1990's. I say this despite the fact that there are now appearances and indications of potentially fundamental and structural change—self-generated change within the Communist societies both in the Soviet Union and the PRC, but I believe if one is looking at this on the basis of the historical record it needs to be demonstrated, it needs to be proven to us that Communist societies do change structurally and fundamentally in essential aspects at all.

And given this resistance to change in the nature of Communist societies I would—and also I might add that geography, as another limit to that, seems to be resistant to change. It is probably not wise to predict that there will be fundamental changes in the character, in the nature of challenges that the U.S. foreign policy is going to have to deal with.

Let me turn to Korea. Here, by the 1990's, I would assume that the current economic issues that dominate the debate within Korea probably are most likely to become vestiges of the past. I have in mind here issues such as the foreign debt.

A reputable economist in town the other day—sometime ago asked of me after a visit to Seoul to his great surprise he found out that the Koreans are worried about foreign debt.

We have been—as you know, those of you who know my country, we have been worried about this debt problem for the last 25 years and now, of course, one comes across references to the U.S. foreign debt, but the worst estimate of the U.S. foreign debt today is about $20 billion. That's less than one-quarter of the GNP in terms of the size—not one-quarter but less than 5 percent of the GNP. We carry our current foreign debt comes to almost 50 percent of the GNP.

And this American economist finds it very odd that the Koreans should be worried about foreign debt. We have been worried about foreign debt. It is still a very live political issue in Korea, but I predict that if we continue the current trends—and, incidentally, I should correct myself here; we are not sure whether it's a trend or a transient phenomenon, but last year we had the first trade surplus ever—the first surplus ever in our history and, as a result, we were able to reduce our foreign debt burden just a little bit by a marginal amount. But if the trend continues I would think that, by the 1990's, foreign debt will no longer be a live political or economic issue in Korea.

And the same thing I think with our market liberalization, if we continue at the current pace, by sometime in the 1990's, we should have a virtually complete market liberalization to foreign products.

It may be very difficult for some of you to imagine the Korean market becoming virtually completely open to foreign-produced products, but I think there is no other alternative. Given the nature of our economic relationship with the rest of the world and given our economic strategy, it seems to me that it is unavoidable that our market liberalization will have to be carried to its conclusion, and that is going to be achieved I predict by sometime in the 1990's.

Politically, we don't necessarily disagree with some of the things that Professor Scalapino suggested here. I would say that by the 1990's we will have come out of this, what could be described as the trauma of the first ever peaceful transfer of power that we are going to go through. And this peaceful and orderly transitional political power will have been established already as an historic precedent and it will have created its own dynamic, so to speak. It will create a situation in which the next leader—Korean political leader in power will find it impossible to consider anything but to act according to the pattern set by this precedent of peaceful and orderly transition.

Of course, it's a fascinating question to ask what kind of political system Korea is going to end up with. I have often thought about this question myself, and I generally tend to agree with what Professor Scalapino—the spirit of his comments, which I understand in these terms, that whatever political system that emerges out of this evolutionary process in Korea is not exactly going to be a replica of the Western parliamentary system—Western democratic system.

I, however, must react to this with some reservation because I am not sure whether there is one institutional model even among the Western countries. We all are aware of the fact that the Great United Kingdom and the United States are separated by the same language and these two countries seem to be separated by the same democratic ideology, as well.

The British political institutions and American political institutions are not exactly identical and, therefore, the only thing I would say in this regard is that, although it is not certain as to what kind of political system is going to emerge, what particular set of institutional structures that we are going to end up with—and, incidentally, it may not be a valid way of putting it. In other words, it is not fully justified to think in terms of Korea ending up

with, because politics is going to be a constantly changing process. There is not going to be an ending up with a terminal stage.

But what I would say at this point, looking at the 1990's, is that the level of tension within Korea's domestic political process is going to be reduced substantially. It's going to go down substantially. The temperature of the body politic will drop down quite considerably, and there will be greater maturity, and there will be greater stability in the way that democratic political institutions function in Korea.

As for creating a security situation, there is one certainty and there is one uncertainty. The certainty, I think, is that the time is on South Korea's side. The equation of power between the two is going to increase in favor of Seoul, given the different paces of economic development, and so on. But the uncertainty relates to the environment in which the Korean Peninsula is placed in.

The relationship among the major powers is not something about which I care to forecast as to its future shape—not within 15 minutes, in any case. It's a very complex and complicated picture with a lot of uncertainties, and the only thing I will say is that, because of the uncertainties within the major power relationships surrounding the Korean Peninsula, even though there is a great discernible trend in our favor on the Korean Peninsula, itself, in terms of inter-Korean relationship, inter-Korean power equation—power balance, it is not wise at this point to predict what the picture is going to look like in the 1990's.

Now, with these assumptions, what can we say then about the nature of bilateral relationship in the '90's? I will simply say—I will make one simple statement as to what it's not going to be like and then try to indicate what it may be like.

Maybe what I am about to say is something that I don't need to say because it's so obvious, but I thought that maybe it would serve some useful purpose to remind ourselves of the certainty that Korea and the United States—I'm talking here about their economic relationship—will never be rivals. No student of Korea is ever going to suggest that Korea is going to displace the United States as the Number One Economy in the world.

Now, Korean GNP is ¼₄th the size of the United States GNP, as we all know. Of course, there will be, as there are, areas in which the Korean industries will have comparative advantage, but Korea will never be able to—and Koreans are not that stupid, and we do not have any illusions that we can be self-sufficient or we can be competitive with the United States across-the-board in an inclusive, overall sense, and we will never be, therefore, a competitor or rival in that comprehensive sense. So, it is a mistake to think of Korea as an economic power in that sense. Now, what then is that relationship going to look like? The only thing that is left for us to say is that the relationship is going to be one of interdependency. We are going to continue to be interactive, increasingly so but in a new environment—in an environment in which the U.S. public will have come out of and come through and gone beyond this protectionist mood, and the Korean market will have become virtually completely open to U.S. products.

And in this environment, then what are going to be the problems? What are going to be the issues? Is there going to be anything that we need to be concerned about?

I see fundamentally the challenge that we are going to have to deal with in the 1990's is the following one. As we become increasingly interdependent, the areas of comparative advantage for each country are not going to remain permanently fixed. The areas in which we have comparative advantage at one period, some of them at least will disappear, and the same goes for the United States. In other words, there is going to be a constant process of adjustment and readjustment in the structure of comparative advantages.

Then the temptation arises for the governments to intervene and have a dictated solution—solutions as products of negotiated settlements as to what the mix of the interdependency should look like—a division of labor, for instance, to be determined by government bureaucracies.

I am going to conclude my remarks by saying that that's going to be the number one temptation that we should guard against—guard ourselves against. We should not allow ourselves to be tempted into trying to manage that interdependency from a dirigisme perspective from the point of view in which the government knows best where resources should go.

I think whatever interdependent mixture—the mix of the interdependency we have at a given moment, in the 1990's, should sufficiently and sensitively reflect the market realities that both countries, both nations can prosper together.

Any other approach then allowing the market forces to dictate the specific mixture at any given moment of comparative advantages is—would be a major mistake and, yet, I think there will be temptations because, having gotten through this protectionist or trade imbalance period, or period of trade imbalance and rapid adjustment in the 1990's through application of government-assisted market opening decisions and other adjustments that were required of us in the 1980's, it is possible for us, on both sides, to have built up bureaucracies, interests, structures that are all geared to manipulating international economic relationships in a bureaucratic fashion, and that would be a great danger and we must guard ourselves against that constantly. And the challenge that we have to face in the 1990's will be how to allow our interdependent economies to interact with each other without government intervention, without an element of creating international socialism, if you will.

Thank you very much.

Mr. MORSE. Well, I think building on what Dr. Scalapino said earlier that the issues in this country are local and that the concerns are very serious, and building on Ambassador Kim's comment about the need for flexibility and the fact that the United States will probably be able to weather this, I think an awful lot of the success or failure of the ability to do that is going to depend on people like Marcy Kaptur, who is here with us this evening in place of Sam Gibbons. These are the people on Capitol Hill who are deeply concerned with American issues, deeply concerned with trade problems and people who are willing to do something about it.

Marcy Kaptur is the third-term Member of Congress from Toledo, Ohio. She was just elected by a 77-percent majority of vote. She serves on the Banking and Veterans Affairs Committees. She is co-chair of the Auto Parts Task Force and the Trade Task Force of the newly-formed Competitive Caucus.

She has been involved in the trade debate, instrumental in bringing a number of issues to the negotiating and legislative agenda.

She has a B.A. in history and economics from the University of Wisconsin, a master's in urban planning from the University of Michigan, and did post-doctoral work at MIT in development, finance and urban Studies.

Marcy Kaptur, we are delighted to have you here today.

**STATEMENT OF HON. MARCY KAPTUR, U.S. REPRESENTATIVE FROM OHIO**

Ms. KAPTUR. Thank you. I'm very glad to be here, Ron, and to join this distinguished panel.

I was just sitting here saying, "My goodness, this is so relaxed. It's like being back in college.—you might actually learn something if you sit this long and are uninterrupted. So, I thank you. This is the quietest moment I've had all day."

I am here in place of a marvelous, intelligent, competent and hardworking Member who has served many more terms than myself, Congressman Sam Gibbons, from the State of Florida, who is the Chairman of the Trade Subcommittee of Ways and Means. And I have great, great respect for Congressman Gibbons. He is a thoughtful man of total integrity who is able to grasp the intricacies of the trade issue probably more than anyone else in the Congress. I talked to him this afternoon, and I said, "Gosh, Sam, I have to replace you tonight. I can't imagine that I ever could, but what should I say?"

And so I will begin with his remarks. When he realized who many of the people sitting in the audience would be, he said, "First of all, to the honorable people from Korea, say 'Open your markets.' That's number one. Let your currencies float and not peg them to the U.S. dollar."

So, I thought I would start out with that, and those are the two most important messages from a most important gentleman in the House.

I will now tell you a little bit about who I am and why I spend half my life here in Washington although it isn't what I intended to do with my life. I was elected in 1982 when unemployment in my district was probably about 18 percent, and I ran because I was concerned about jobs in my community.

I come from a district which is both agricultural and industrial and is a port city. The job issue led me to the trade issue. I did not major in trade. It is something I have had to spend too many hours learning about. I, along with several other Members of Congress, have spent five years bringing the message of the 1982 election to the Congress of the United States and to a point where it is now on the front pages of every magazine in this country and I dare say the world. It has not been an easy struggle, but I consider it one of my major accomplishments that trade is even talked about.

Because I do represent a port city, I often go out in the spring and welcome visitors. The first ship into my port in 1986, was a Japanese ship. And that ship was full of steel that had come from France.

Our dock workers work hard for a living. Unloading isn't something they enjoy doing because they have friends throughout Ohio who are unemployed in the steel industry.

Mazda Corporation, a Japanese firm, has decided to build a plant 20 minutes north of where I live. Now we are finding Japanese steel coming in. We have had to set aside a special place at our port to ship this steel up to the plant that is located north of us.

I merely point some of these examples out to give you a sense of where people in my district might be, because trade is very, very serious political issue in this country.

At the same time I represent a community which houses a major state branch of the Ohio State University. We call it the University of Toledo. We have a marvelous, marvelous university president who is an internationalist, and many Korean students at the university. We have quite a large international student population, and a community that wants to reach out to other parts of the world.

We have sister cities in China, Spain, and South America to try to build better a understanding outside the business community within the educational community and our community at large.

The automotive industry is a key industry in my district, along with all of the parts and all of the related services that go into automobiles. The people, the businesses and the workers in my district are in transition because of changes in these industries.

We see all kinds of things happening. We see major U.S. corporations out-sourcing production. We see the purchase of foreign components to go into U.S. production. We see many imports coming into this country.

Literally, one-half of the value of U.S. automotive vehicles sold in the United States were manufactured abroad or in companies that are owned by foreign interests located in this country—one-half.

I compare that to a nation like Japan where less than 3 percent of the cars on their streets—are foreign made. They certainly are not buying Korean cars. I know that they are not buying U.S. cars and they are certainly not buying U.S. parts.

In fact, we learned that of Japan's $25 billion share of the U.S. market—one-third of this market, less than 2 percent of the content—the value of those automobiles is U.S. made.

This does not sit very well with people who are receiving unemployment checks or are having to leave their job in an auto plant, making spark plugs, or glass, or some part of a hydraulic system to go work at MacDonald's for $3, or whatever an hour. But that's happening in my district.

Families have changed. Husbands may have two jobs in the service industry, a wife may be working. It's very difficult for many of our families to survive this so-called transition.

We are worried about Hundai and whether the plants that are being set up in South Korea will follow the same pattern as the Japanese. We don't know.

As a Member of the Congress, I am very concerned about the twin deficits that Bob talked about. We understand the connection between the budget deficit and the trade deficit. We also know that what's at stake here in our country is the standard of living that we have come to know.

According to recent polls, 70 percent of the American people feel that import controls, even if it involves price increases to the American public, are preferable to what we are experiencing now.

Ambassador, you mentioned that the size of the economy of South Korea compared to the United States is rather small. Reflecting an opinion that comes from a district like mine, if everybody gets a piece of America, then America has very little left of itself. And so we are looking at how the parts add up together.

I think that the period we are living through now is an extremely delicate and dangerous one. As I look at the business pages and I see what's happening on Wall Street; I look at the securities purchased by foreign creditors of the U.S. public debt; I look at the financing of private sector development in our country and the amount of foreign financing that has made that possible. I can see how easy it would be to create enormous instability in this country. And I truly am frightened about that as just one Member of Congress.

I feel that the trade laws under which we are operating are hopelessly antiquated. We are operating under the old Western Model that created all the GATT rules as we know them and, yet, as the Ambassador has so well described, we have types of market systems other than the American-British-German Model that are working here, and the trade laws of the world are absolutely inadequate.

Even if we passed the current trade bill, H.R. 3, I have no illusions that we are going to somehow as a world of very different economies deal with these differences between us.

If we look at the trade bill that is being drafted in Congress right now, concerns that have been voiced across this country end up as parts of that bill, specifically, provisions dealing with government barriers, tariffs and duties and practices of governments that make it impossible for us to have what we like to think of in America here as free trade. We find business practices and certain relationships in the private sector with the prior networks that would be illegal under our anti-trust laws being the rule of the day in other nations.

And so we have sections of the trade bill that strengthen section 301 to include private business practices as items for international trade negotiations.

Another area of concern is labor rights. How in the world do we, in a nation where people may earn $10-an-hour to produce a product at a certain price which includes labor content as some portion of that price, compete with a country where the labor rate may be 88-cents-an-hour, or $1.50-an-hour and produce a product for sale at a certain price?

There is a section in the trade bill that deals with labor rights and, as a result, of course, wage rates. And I think a real issue out there in America today is, does America lower its standard of living to the rest of the world, or does the rest of the world raise

their standard of living to the United States? It's a real question in the district I come from.

The third area has to do with our trading relations with nations where there are huge trade surpluses, or deficits, depending on which side you're on. The magic figure he uses is 175 percent of a running total. Over what period of time do we expect that to be reduced and by how much per year? And how tough are we going to be in this bill that we are drafting? We will be debating that in a couple of weeks with the Gephardt amendment to the trade bill.

Finally, another section that's probably of interest is exchange rates. And with the wild fluctuations we can see in the marketplace, do we begin to set up a band within which exchange rates can move or do we let the market work on its own, with certain countries having very controlled currencies in spite of the fact that we're all supposed to have floating exchange rates and operate on the same system.

Our trade bill attempts to address these in some way.

I think for me, just as one member, I truly question the policies this country has set in place toward other nations that have been focused on export-led development policies as the way for other nations to gain freedom and to gain economies that work, and to raise their standards of living, and to keep the U.S. market as kind of an important linchpin in that process where we absorb the exports. Whether you're talking about South America, or whether you're talking about South Korea, or whether you're talking about Japan, I wonder whether that policy makes sense anymore for the United States. It certainly doesn't work in South America.

And so this whole export-led development policy that was meant to enlarge freedom has instead cost Americans a very heavy price my people, the people I represent a very, very heavy price.

Finally, let me just say an equal concern is over-capacity. Bob talked about how to market economies in societies that are democratic where there are lots of freedoms, but how in the world do we deal with the over-capacity that is targeted at this marketplace?

Just in the auto area, which is one that I know somewhat about now, by 1990, we will have 4 million more cars targeted at this marketplace than Americans can purchase. General Motors is closing 10 plants across the United States—thousands of Americans not in my district at this point but in Cincinnati and other places. Thousands and thousands of Americans are being thrown out of work. How much more of this can this country take?

And I think that part of the emotionalism of the Congress, and certainly myself, is an attempt to defend where you come from and to defend your turf even knowing some of the consequences of that protection.

And I frankly, Mr. Ambassador, do not find the terms "protectionism versus free trade" real helpful in any discussion anymore. I think the words have no meaning.

When reporters ask me that, I embarrass them publicly on the protectionism issue. I say, "If that's the only question you can ask me, it doesn't deserve an answer."

I think that the world has become so much more complicated and the types of economies we are dealing with so much more complicated that we, in fact, have to talk about the types of econo-

mies—planned economies, mixed economies, Communist economies—whatever they are, and begin negotiating in some systematic way based on those models, because no longer is the free market or the protectionist model even relevant to what's happening out there.

I'm sure Japan would call itself a free market economy and it certainly isn't.

So, I think that the time is drawing short for us to create international bodies where we can negotiate in some civilized way. Even with the passage of the U.S. trade bill, the major challenge is to us as a world to try to work these issues through. I think the time is really closing in on us, and I honestly don't know if we have the time.

That's a pretty negative message but I think it meets the reality.

Mr. MORSE. Thank you very much.

Well, now it's your chance to participate in what you have listened to since 10 o'clock this morning to 9 o'clock tonight. Everybody should be just chock-full of questions, anxious to pursue some points here.

And if those of you who would like to ask a question raise your hand, identify yourselves, and I'm sure our speakers will be happy to share their thoughts with you.

QUESTION. This is a question to the Congresswoman.

This morning, one of the Korean speakers talked about how difficult it has become for Korea to respond when the United States gives our trade negotiators a short deadline demanding access immediately. And the speaker suggested that it would be better off if instead the United States were to give Korea a list of issues that we would like to have resolved. And as I recall, he used the period in a 6-year period.

I would be interested in hearing, as a Congress watcher myself, your perspective on how difficult it is for you, as an elected official, to have a negotiator say to you, "We're looking at a 6-year framework for resolution of this trade issue."

Ms. KAPTUR. I can speak from the perspective of one arena in which I have had enormous experience, and this is the auto parts area. We traveled to Japan a year-and-a-half ago in July of 1985. At that time I had never intended to go to Japan. I wasn't an East Asian scholar. I have no Japanese relatives. I did not think my job would take me to Japan and, in fact, it did.

And that is where we began to understand the magnitude of what we were dealing with and the business practices that were affecting jobs in my district. Our companies could literally not bid into work in Japanese firms either in Japan or in the United States or in the replacement parts that go into motor vehicles.

Once we had the statistics together and before the Japanese Government began protecting those statistics so we couldn't get at them, we learned that they were purchasing under $200 million a year of parts into that $25 billion worth of production that sold here. It took us a year, and we were Congress—Congress going to Japan.

It took us a year to convince our own government to move the auto parts question to the top trade negotiating item between the United States and Japan.

Those negotiations began last August. They came out with a mid-term statement in early February which I consider to be almost laughable. There are no targets set. There are no markets open. Behavior is not changing, and the Administration tells us that they are going to complete these negotiations in August. They consider this interim statement that was issued in February a real achievement. And I will be happy to share a copy with you and you tell me whether you think it's an achievement.

But it has taken this long now. This July will mark the second year. I don't believe they are going to change their practices in auto parts. They haven't in any other area.

And a gentleman who was here a little earlier, Congressman Sander Levin, of Michigan, a great internationalist, said, "No, Marcy, you must stay on the ship. Let's follow this through. Let's really try." I said, "Okay, Sander, if you say so, let's do it here." So, we've stuck to it. And you know, you get the impression that, "Well, people are waiting for you to get defeated. Then that institutional memory will go away. The Presidential elections will come. They'll change the trade negotiators and inside the administration it will be business as usual."

So, I have become very frustrated with the way we do business in this country, the way we conduct ourselves in the trade arena. I see our country, with very inexperienced negotiators, going up against the Japanese that I consider to be some of the smartest, most experienced trade negotiators in the world—30 years' experience up against our lead negotiator who may have two in the trade arena with no background in the automotive industry. So, I would say this country is out-gunned.

In some ways we lose because we set ourselves up to lose. It takes too long. Our people are too inexperienced and we don't have the kind of commitment at the federal level that we need to make things work for this country, to be serious about this.

Mr. MORSE. Yes, identify yourself, please?

QUESTION. Congresswoman Kaptur, you have mentioned about auto parts, but this case I think rather recommends for you to distinguish between the Japanese case and Korea.

I am from one of the joint-venture automobile manufacturing companies, called Daewoo. We are in a joint-venture with General Motors.

Last month when we brought here huge buying missions from Korea headed by a trade minister, Peter Guyer [phonetic] from USTR, my company, General Motors, thanks to our government's recommendation and General Motors' executives own decision, we have transferred of our auto parts purchasing from non-U.S. to mostly United States.

If I bring the figures, last year we bought around $19 million and that's 16 percent of General Motors' total import from outside, among which, $19 million made in the United States. But this year we are going to increase our auto parts made in the United States almost $200 million. More important, this $200 million reflects 36 percent of total auto import outside of General Motors.

In that way Korea—in the case of Japan, I don't know, but as long as quality-wise, after-service-wise and price-wise is available, most of the Korean auto makers try to buy these auto parts made

in the United States, because we recognize the market is here; therefore, by letter of trade promotion is our target.

Therefore, I would like to emphasize to the Congresswoman that this point is one of Korean up-to-date movement and most of my colleagues support my decision.

Thank you.

Mr. MORSE. Yes.

QUESTION. I have a question for Professor Scalapino.

You were talking about the political system that is likely to emerge in Asia, the emerging of the dominant party. And we had that emerging in different degrees already.

Would you talk a little bit about the difficulties of a system like ours, dealing with that kind of a system in problem solving—and let me just give an example of why I'm asking the question. Many times when we are trying to solve a trade problem, the American interests will look at the country on the other side and will essentially dismiss the political conflict and constraints in that other society as phony because, after all, we all know that President Chun or President Suharto or President Chiang Ching-Kuo [phonetic], if he really wanted to do it could do it with the stroke of a pen or with one order to the appropriate authorities.

And since you are saying that this model of a dominant party is likely to be the one that we are going to face for sometime, would you talk about that for a little bit?

Mr. SCALAPINO. There are many different types of dominant party systems. It is true that in some states, the top leader can overrule key interest groups in his society if necessary to enforce a decision. But I would point out that even in most dominant party systems, there are restraints on leadership.

We are seeing this in Japan today. Nakasone's popularity has dropped to an all-time low for the period of his tenure in office. Why? Because he adopted policies, some of them under foreign pressure, that his own electorate did not support. Some elements of his own party also did not support him. Japanese public opinion polls illustrate this development clearly.

In Korea, there has been an underlying struggle between the government, which has tried to push liberalization and representatives of the private sector who wanted more protection. This struggle has been serious, and it continues.

Thus, dominant party systems do not necessarily give absolute power to the leadership, though I would agree with the implication of your main point. Generally speaking, continuity and a strong bureaucracy underwriting the dominant party provide the type of relationship between government and economic interests that is much more cohesive than the one that exists in the United States.

Some people have debated whether the United States should have an industrial policy and what that means, because it means very different things to different people. Without getting into the question of definition, I would say that, in all probability, we are likely to move toward something that one could label "industrial policy."

Let me make one final point on this matter. In some Asian societies today, we are moving toward a stituation where power of the bureaucracy is being challenged. Japan is one of those societies.

The reduction of power is only incremental, but I think MITI's role, for example, was more powerful five years ago than it is today. The private sector—the Japanese business community—is beginning to play a more critical role. Behind this development, the professional politician who answers to that community has become more prominent than the bureaucrat-turned-politician who was the historical leader of the Liberal Democratic Party.

From our standpoint, that's not necessarily good, incidentally, because the professional politicians are people who may have a much stronger sense of their personal and group interests than the bureaucratic officials who may be able to see the national interest. But I would suspect that the challenge to the permanent bureaucracy from private interest groups and the rise of the professional politician are going to grow in Asia.

QUESTION. Bob, let me ask you just a question. Just for a minute, pretend you are somebody who had some leverage in government and you've been seated in a situation in which you are a negotiator. And on the basis of your experience with quasi-authoritarian regimes and different structures in Asia, what are we doing wrong when we try to negotiate American national interest with countries that are so different than ours?

Mr. SCALAPINO. I do not think that it is at all wrong to negotiate with American national interests uppermost in mind. The point that I would stress is that we would have much greater success in those negotiations and a much greater validity in our position if we could deal more effectively with those economic problems in this country that are not the responsibility of authoritarian governments. One cannot dismiss the awesome nature of our budget deficit and the fact that nothing is really being done about it at present.

I am not politically naive. I know that no one wants to pay higher taxes, or at least one wants the other person to pay them. And very few individuals want governmental expenditures cut if that impinges on their interests or perceived needs. Yet everyone who is serious about these matters recognizes that this problem has to be tackled, and until it is tackled seriously, we can negotiate constantly with foreign countries, but we are not going to resolve the basic problems.

Moreover, we have to face up to this problem in a bipartisan way. I have great respect for the majority leader in the House of Representatives because I think he has begun to say things that need to be said to the American electorate.

The fact is—and I think Marcy pointed this out though she used different words—we are living beyond our means. The precarious aspect of this is that the foreign money pouring into this country is allowing us to live beyond our means. And if that spigot were ever turned off, if foreign investors ever lost confidence in the American economy to the point where their money did not come here, we would be faced with a major crisis almost immediately.

I do not see such a development on the horizon primarily because we are still the best source for investment in the world, given all the factors, political as well as economic. It is a fact, however, that we are in precarious shape economically. And if a Presi-

dent who came to office pledged to a balanced budget cannot resolve the problem, who is going to do it?

Mr. MORSE. Ambassador Kim. Then we will take some questions.

Ambassador KYUNG-WON KIM. I am sorely tempted to express my complete agreement with what Professor Scalapino just said with regard to the importance of reducing the fiscal deficit. I will, however, refrain from doing so because for a diplomat to endorse a point like that would make me look as if I were lecturing to my American friends, which I have no intention of doing.

However, I thought that I should, after having listened to Congresswoman Kaptur describe very eloquently the American public perception of what the realities are, maybe I ought to say a word or two about the Korean public perception of what it is all about.

The expression "export led growth strategy" or "policy" was used. In the Korean mind, we are not exactly led by export. Of course, we have seen expansion of export but on balance, as I pointed out earlier, last year, 1986 was the first year we had a net surplus. We have always had more import then export until that year.

In our bilateral trade with the United States, it's only in the last few years that the table turned, and we began to have a surplus. For more than 30 years we have had a deficit with the United States in our bilateral trade. And I don't believe our public has forgotten this completely yet.

And, therefore, for the Korean public to hear our American friends bitterly complain to us about Korean trade surplus taking jobs away from American workers, impoverishing the American nation, lowering the standards of life in this country sounds rather strange, out of proportion, misplaced, out of context, not in line with reality, that reality as we perceive it.

So, we ask ourselves, "What is it all about?" Korea is, after all, 1/50th the size of the United States. The area of the land is about the size of Virginia or smaller than Virginia. More than 40 million people squeeze into it without God's help and others without resources, without a drop of oil and trying to make a go of it, trying to improve our standards of living a little bit, just trying to pull ourselves up a little out of that historic poverty that we inherited and the destruction that the war in 1950 bestowed on us.

And we hear arguments coming from our friends, our benefactors, our great allies the American people, saying, "What is this? You are having a surplus with us? You are taking jobs away from the United States And what's worse, you are paying your workers low wages." And then we become really troubled. At least I become philosophically troubled whenever I hear references to our labor rights, low wages, and whatnot.

What does it really mean? Does it mean that our American friends want to shut off the rest of the world and not allow us an opportunity to improve our lot a little just to protect American interests. Are our interests that exclusive mutually? I mean, is it that there's some game? Is it some kind of game that we are—rivalry in which one wins and the other loses? To the extent that we improve our lot the American workers suffer, is that really true? Is it really true on the face of facts that, for instance, as the Ameri-

can trade deficit grew, American unemployment also rose? Is that really true? Do the statistics show us?

We have looked at the statistics ourselves and we don't see that. We hear a lot about unemployment and I have visited areas. I have been to the Bethlehem Steel Mill up in Buffalo. It is very sad—tragic. I can empathize with the conditions of the workers who lose their jobs and had to move away. A deserted workers' town was really just, you know, horrible, but, on the other hand, if you are looking at the macro-picture—the whole picture—the United States economy as a whole has there been a massive unemployment going on in this country?

More jobs have been created—I sound like a spokesman for President Reagan, but more jobs have been created. Americans live better than ever before.

I remember going to college in this country in the 1950's, having a teaching job in this country in the 1960's. I think kids out of school these days live better than they used to in my time. What is this that I keep hearing about "impoverishing" of the American nation?

And what about labor rights? I tried to look at the figures, too, and I found some interesting things. For instance, if you look at the growth of labor wages for the last 10 to 15 years, Korean wages, labor wages have been growing faster than anywhere else. They have been growing certainly faster than the United States.

This is a bad argument. I shouldn't say this. This will make all our American friends jealous. I shouldn't have said that, but I said it, anyway.

And if you take monthly income, take-home income of workers as a proportion of per capita GNP of the country, Korean workers are better off than their American workers. They get paid better as a proportion of Korean per capita GNP compared to American workers in terms of their income as a proportion of the American per capita income.

What all this means—you know, those poor wages that we are paying our workers, it means that we are a poor country. We are a poor country. We have a per capita income of only about $2,000.

Now, you don't have to compare laborers' wages. Look at your executives' salaries—huge, astronomical distances between the two scales.

What are we doing here? So, I ask myself whenever I hear references to labor rights, is it true that we are gaining at the expense of our American friends? We are impoverishing our American friends? We are condemning them to lower standards of living because of our trade policies, because of our economic growth? I am not convinced that that is the case.

If you look at the last 20 years, if you try to go back to the last 20 years—30 years, and if you had to start all over again, and if you decided because of what happened in terms of trade imbalance, and so on, the United States is not going to allow other countries, allied or not—whatever, to bring their products and "dump" them, quote-unquote, on the American market; therefore, we will close our markets, go for a "fortress America" policy in the economic arena, as well, would the American people be as prosperous as they are today? Would we really be all this well-off today?

I'm sure we would have—I was going to use a strange expression but I just remembered I am an ambassador. Without American market—access to the American market, we know we would be nowhere, and that is why we are grateful. And that is why I have absolutely no moral defense—absolutely no moral defense whenever Peter, over there, and his friends and his allies tell us to open our markets

The only thing I can plead is consideration, timing, pacing, conditions, phasing-in, but, intellectually and morally, I know we have to open our markets. That's all there is to it.

Now, what about the currency situation—the exchange rate? Of course, I am not going to pretend that we are letting it float freely. We are managing it with a certain degree of prudence and caution. But I would plead this please look at where we are, Korea.

One of our allies or friends in the Asian NICs-Caliago [phonetic] countries, I guess—I will not name the country—is sitting on top of a $50 billion surplus and has half the population of my country. We are sitting on top of nothing. We are carrying on top of us a burden in the order of $45 billion in foreign debt, which is about 50 percent of our GNP.

If we do not manage our economic policies with prudence, with caution, then it is possible for us to come in and plead, "Please let us join the Baker plan." And you don't want us to do that, because we owe a lot of our foreign debt to American banks. It is not in the interest of American banks; it is not in the interest of the American economy; it is in the interest of the international financial community to have us start defaulting, which we have no intention of doing, and we have not and will not.

And that is why we ask a little bit of understanding when we say, "Frankly, we need a little more surplus for a few more years until we manage to bring it down a little, the level of foreign debt." We don't have any intention of wiping it out overnight. We are under no illusion that that is going to occur. It would be economically stupid of us to try to do that. But we simply believe that prudence dictates that we bring down the level of exposure a little bit further down.

And in the meantime, if we do not allow ourselves to become overwhelmed by the problems of the moment, by the passions that prevail at this time; if we continue to maintain our cool heads and allow our trade relationship to expand, then we will prosper, both. And I'm sure that we are not engaged in a zero game. We can benefit only each other in this way.

Mr. MORSE. I think there are a few questions. I think it would be good at this point to go around and sort of get everybody's question, and then let the people up here field the questions.

QUESTION. Just following on this discussion, if this legislation is enacted, what degree do you think anti-Americanism, which we have heard of—my impression is that it is not really anti-Americanism but some frustration with the system at the present moment—will increase and to what degree could that anti-Americanism adversely affect the democratization process?

QUESTION. I wanted to ask Representative Kaptur and perhaps Dr. Scalapino about their feelings with regard to consumer preferences in this country. And you mentioned the poll that 70 percent

of the respondents said that they favored increased quotas on imports and tighter controls on imports, but I dare say I think if you polled the same people you would find that in their households, among their clothing, their appliances, their automobiles, you would find significant items that these people have bought from overseas, probably from Asia.

Is the American consumer, the two-income family that can afford three television sets, two VCRs for those television sets, two automobiles, a second commuting car, is the American consumer really a villain here? And how can what you're trying to do change consumer preferences, or is this really not necessary to change, in terms of what you would like to see happen in terms of trade?

And I guess for you, do we need, with regard to consumers, some good, old-fashioned American nationalism in the area of purchasing preferences?

QUESTION. I think there is no way that one can come away from this discussion, despite Ambassador Kim's best efforts, with anything other than a rather, shall we say, cautiously pessimistic view of the economic situation and the economic relationship between our two countries.

My question has to do with the relationship between that aspect of Korean-American relations and the notion that Bob Scalapino raised in his talk that it may be time to start thinking of a different sharing of the military burden in the military alliance between the two countries, and so I will ask an aspect of this question to each of the panelists.

I will ask Bob, do you think there will be, projecting forward, a connection between the economic and the strategic aspects of the Korean-American relationship?

For Congresswoman Kaptur, I will ask, do you think there should be a connection; that is, do you, as a Member of Congress, believe that American policy on the military side should be shaped with an eye to the economic relationship between our two countries?

And for Ambassador Kim, I will ask, how does the Korean side look at the prospect of a phased, gradual American withdrawal of ground forces from the Korean Peninsula?

QUESTION. My question is a little more simple and might just spread broadly around the panel, but I was particularly interested in the feeling that went into Congresswoman Kaptur's remark about the behavior of foreign firms, particularly Japanese and Korean firms, and also the limitations or weaknesses of the U.S. Government in terms of trade negotiations.

I wonder, in particular in your case and perhaps the other panelists could have something to say about this, what about the—what are your feelings about the behavior of American firms? For instance, how do you reconcile stockholder interests in the short term perhaps with longer term in a national interest? And can this be reconciled in our case without essentially penalizing consumers—that is, without subsidizing domestic consumption?

QUESTION. A question for the Congresswoman, if American citizens are so riled up in your district, why aren't they all riled up against all of the issues that are causing the problem instead of thrashing out against the Japanese ship that happens to come in

the harbor with Argentinean steel or by the extension of Koreans that are soon to come?

Why aren't they riled up against, for instance, poor local education that is partially the cause of their unemployment? Or the lack of their own knowledge of the international realities? Or the national government that they are producing or are serving under? Or the precipitous decline of their own work ethic? Or the half-baked quality of their products and the decline in their own pride of workmanship?

These are the hearts of the whole—of the picture. Why is not that the American constituents do not look at these whole things and, if there is a revolution that we are going through in this case, why do we not make a resolution of this matter rather than looking at just one part of it?

I don't understand the American voter anymore. We are so rectilinear in our viewpoints.

Mr. MORSE. Were there some questions that other people had back there?

QUESTION. I am Ambassador Kim's Deputy for Economic Affairs. Since I have been here only 4 months, I have a problem in understanding your system, but I was stimulated by the Honorable Congresswoman Kaptur's comments that the U.S. administration seems to have a lack of negotiation skills or experience much less than she expected to see.

Well, the present setting is this, that the United States, in 1987, with so much trade deficit and fiscal deficit who has to deal with governments like Japan, Korea, and other Asian countries whose governments have a more effective means to control the trade affairs, now, my question is you have the U.S. administration and Congress—I have been learning that you have the check-and-balance system between the two branches of the government, but it seems to me that these days it's check-and-check.

And then frequently the Congress—I do not understand the role of Congress in the very important negotiations vis-a-vis other countries like Japan, Korea and Taiwan because the Congress is the place where the regional interest and the national interest frequently clash each other.

So, I would like to know how she could explain the future—more effective negotiations to be conducted by the administration under these circumstances.

Mr. MORSE. While we let the three panelists think through what selectively they wish to respond to—and we will do it in sort of a reverse order in fairness. We will let Marcy go first and then this will be their final comments for the evening.

But let me just reflect for a second on something. We have had an internal seminar here at The Wilson Center with some of the Fellows. We were looking at the rise and fall, or as we call it now, the fall and rise of empires and, if you go back and look at all of the indicators through various empires, coming up through the British situation and looking at what's happening in the United States, there's an awful lot of big questions can be asked.

And I think the fundamental one is the one related to what Bob Scalapino said today. Is it possible for us to maintain the system, given the stress that it's under? And the system is a global system

of security. It's a global system of economic power. And is it possible to distinguish the strength of the system that's developed without looking both at the military and the economic relationship? And when you have countries that are primarily focused on economics and other countries that are primarily focused on military strategic questions, can we maintain a two-front struggle in a situation in which there is not more of a systematic form of burden-sharing? And is, as an editorial in The Washington Post as an oped piece the other day, was the end of an era with the shift to the Pacific Basin, the decline of Europe and the United States economic—are we, in the broader sense of what Ambassador Kim is saying, facing a totally different world structure and one that we're not perhaps even capable of managing as we look ahead?

And so maybe it's less optimistic perhaps than Ambassador Kim suggested.

Marcy, would you like to lead off the final comments?

Ms. KAPTUR. I just wanted to follow on some of Ambassador Kim's remarks to say that wages in this country for the average American family have not grown since 1975. That's discounting for inflation but, nonetheless, it costs a young couple out of college almost half of their income to afford a home.

Now, this may not be important relative to your country because so many of your families have never been able to afford a home, but compared to the generation that preceded them, the average American young couple now that graduates from college and tries to buy a house spends a much larger share of their income on basic necessities.

You asked about education. It's much harder for a family to send their children on to school now than it was for their parent's generation to do it.

And if we take a look at the unemployment figures in our country, what's saving us, ambassador, is that the birth rate went down. If we had the same number of people entering the labor force as we did back in the 1960's and 1970's we would have unemployment in this country well over 10 percent right now.

And if you look at certain industries, like machine tool, for example, which is 25 percent owned by foreign interests in our country; the truck industry, over half owned by foreign interests; the steel industry, 15 percent; the automotive industry, who knows—depends on how you count it, but one of the reasons people can't afford these things is, in fact, because there has been enormous shrinkage in the U.S. global share of manufacturing and agriculture, which is where our real wealth came from.

So, in effect, we have a lower standard of living. As you are struggling up the ladder, we are coming down the ladder, slowly, but it's happening to the younger generation of Americans that are out there.

So, I wanted to comment on that first. There are so many questions. Trouble with foreign investment is a great, great thing if they behave as U.S. companies behave in these countries.

For example, when you have a Honda Marysville which says it's providing jobs, but then 75 percent of the parts used—the value of parts used in that production come from abroad, and the companies that follow the mother plant are all owned by that mother

plant, and U.S. companies cannot bid in a free way on that work—in fact, they can't even get phone calls returned or are able to turn in a bid with specs, and so forth, into that production and, as a result of not being able to supply to the original equipment cannot get into the lucrative replacement market, then you have a system which really I think should be taken to court under our anti-trust laws.

So, if they behave according to our philosophy, fine, but what we are finding in the auto industry, that is not the case.

The gentleman who asked me what's the role of Congress? My answer—elect a new President. Get somebody that we can agree with. Clean out the International Trade Commission. I am frustrated with this Administration on trade.

I don't want to hog all of the time, but I want to say that people are concerned about all the issues that you mentioned. They just don't know what to grab hold of first.

And I really think that the lack of access to several markets has poisoned the discussion to a point where it's much more difficult to focus on the budget deficit, because every single company you deal with, every single union you deal with gives you the horror stories. And until that is cleared, you are not going to get at the other issues you're interested in, because the feeling is so strong that America isn't being given a fair shake.

And really, Mr. Ambassador, to you I would say I don't like some of the things U.S. companies did in this century—especially in this century, and other nations. I think that a lot of times I would agree with the Chairman of the Trade Subcommittee that we behave as though we set up slave markets around the world and people work for very low wages to produce for the American consumer, and I don't think it creates long-time friends for the United States.

So, I'm not a supporter of all the behaviors of U.S. companies abroad but I think that to get at some of the other things you're concerned about—education and all the rest—you have to deal with some of this lack of market access issue or you're never going to touch those issues. I went out the other night to buy clothes for spring. And I have decided just to have my clothes altered because everything I found was made in Taiwan.

And you know what? As an American, I feel sorry for the garment workers in New York and the textile workers in South Carolina. They don't make wages as high as auto workers do by any shape. And I couldn't find those clothes.

And so there comes a point where maybe the consumer does have some role to play in this. I'll end there.

Mr. MORSE. Mr. Ambassador?

Ambassador KUNG-WON KIM. Quickly on the relationship between falling birth rate and the unemployment picture, I think you must also add the entry of an increasing number of women into the job market, and the picture becomes very complicated. And probably we should just drop the topic at this point.

But also as for the U.S. disapproval of the way American companies behaved in other countries, of course, there were rather unattractive aspects to the way they behaved and they continue to behave—some of them, anyway, but I would like to remind myself,

at least, of the fact that God or history works in mysterious ways and one of the ways in which he works is by exploiting human greed to benefit mankind.

On the effect of trade—I think it goes back. I can see now as we talk more. The difference between us is really fundamentally a philosophical one. Does humanity advance it's whatever—moral—whatever interests through only a means that are morally justifiable in some way, or do we get results through processes that are very curious, to say the least?

But on the impact of trade legislation on anti-Americanism in Korea, let me, first of all, point out that when we talk about anti-Americanism we are talking about maybe 2 or 3,000 students out of 1.2 million university students. And there are people shaking their heads and I can see that, but I will challenge anyone to prove to me that the anti-American sentiment on the campus of SMU is any greater than on the campus of Harvard or Berkeley.

And particularly if I go back to the 1960's when I was on the NYU faculty and my classes had to be canceled because of bomb threats all the time, I take a somewhat relaxed attitude toward the emergence of anti-American sentiments among some university students in Korea.

In fact, what is happening in Korea is Korea is finally beginning to look like any other non-Communist country. We used to be unanimously a pro-American country. There used to be unconditional, absolutely universal consensus in favor of our American alliance without a single dissenting voice, and that phenomenon needs to be explained, and that no longer attains, that situation, incidentally. And I will not go into the reasons why that condition existed. That, I think, was an anomaly. No country can be so completely wholeheartedly devoted to another country.

So, what affect is trade legislation going to have on anti-Americanism in Korea? It will not necessarily endear our American friends to our Korean fellow countrymen. But you don't look at trade legislation from the point of view of its impact on anti-Americanism. That's not the major concern that I have with the trade legislation.

It depends on what kind of legislation we are going to see come out of the whole process, and I simply trust in the wisdom of the American process to produce something. If it's going to produce something—it's look likely—to produce something that will not damage the international trading system, because the world trading system is one of those things which is not difficult to destroy but once destroyed it will be almost impossible to resurrect it in a short period of time.

And one quick answer to what about the prospect of phased withdrawal of United States ground forces from Korea. A very correct answer to that is it all depends. On what? If we obtain eternal, durable and verifiable peace on the Korean Peninsula, it depends on the degree of the threat that we face from the North Koreans.

But one thing that I would point out is that the reason why we have the ground troops in Korea—United States ground troops—one division—is not necessarily to add to our fighting capability but it is there to assure deterrence, and to make sure the North Koreans do not repeat their mistake of 1950.

But let me also probably—since the question was raised in the context of the economic relationship, I should probably add that my government is contributing to the maintenance of the U.S. forces in Korea on the scale of $1 billion per annum, both in terms of housing subsidies and the cost of maintaining equipment, and whatnot, and the cost of the joint exercises. It comes to about $1 billion and proportionately, as a proportion of the country's defense budget—total government budget of the country's GNP, per capita, and what-have-you, I would dare say that's one of the, if not the highest rate of contribution that any allied country makes to the station of the U.S. military forces in their country. And that is an indication of the appreciation that we have of the value of maintaining the United States ground forces in Korea.

Mr. MORSE. You have the last word, Bob.

Mr. SCALAPINO. I think that I should start with a defense of Berkeley. We actually have a Young Republican Club at the university now. At Berkeley and at most campuses you could get 100 people to join an "Earth Is Flat Society," but we are in a relatively moderate era at present.

I agree with Ambassador Kim in that I don't think the economic issue will impinge upon our strategic commitments in the Korean case. Korea spends about 6 percent of its GNP on security. I think there is a recognition of that in this country. South Korea is sharing the security burden.

This matter will continue to be an issue with respect to West Europe and Japan, but that is another question.

I would like to conclude with a couple of general points. First, I think that if there has been any benefit to America from this rising competition and friction in the economic arena, it is that many elements in the private sector—both business and labor—have reexamined the issue of competitiveness, have sought to increase R&D, and in some cases have inaugurated a new management-labor relationship. And I think that, with the proper encouragement—and I don't mean by this necessarily government action but total encouragement in terms of public and private sector economic policies—we can be competitive in those areas which are critical to our future.

These are clearly the high-technology areas. We can be on the frontiers of these fields, in my view, if we keep our eye on the central requirements--more funds for research and development, more emphasis upon expert training, and an understanding of where the priorities of the 21st century are going to lie insofar as advanced industrial countries are concerned. This will put us into a highly competitive relationship with Japan. There is simply no way around that, in my opinion.

However, this raises the second point. The Japanese are going to face some of the same problems of external competition as us. This has already manifested itself in fields like shipbuilding, iron and steel, textiles. Thus, the second issue, is that whether we like it or not, as everyone here has said, we are moving into an age of intensified interdependence.

We should undertake a comprehensive study of the problems of interdependence now, because there are multiple issues to be resolved. Marcy has mentioned some of them. There are many

others. Now is the time to look at these problems from a middle- to long-range point of view.

In many fields, we are going to have such a mixture in terms of origin of the parts that go into the finished product that we will not be able to specify a country of origin. We must raise the question, "What are the rules of this new game, What ought to be the policies of each country in the era of interdependence?" We are not abreast of this sufficiently, given the enormous impact it is going to have on this and other countries.

Let me suggest a final point. In my view, economics is going to be in command of the future international order. I say this as a non-Marxist. But I think that economic relations will be increasingly critical to issues of security as well as of political relations.

We cannot have close security relationships over a protracted period of time if we are bashing each other over the head in the economic arena, or if our people are turning inward because of the economic problems that they face.

One of the advantages of tonight was that we got from Marcy a close-up view of what people in an industrial community of America are really thinking. I would not challenge her evaluation of that at all.

I could give you another look from the Silicon Valley perspective which would be equally critical, although it does not relate to the same sector of the American economy.

These problems have simply got to be faced rationally and quickly, and that is why I say studying the problems of interdependency is one important aspect of this, because that is where evolution is taking us. We know, for example, that the Japanese see investment abroad as a means to avoid protectionism, to reduce labor costs, and to share more extensively in the domestic market.

That has its merits. But it also has its problems, and we had better face up to these problems before they produce yet another political crisis.

In the final analysis, however, one can afford to be cautiously optimistic if one can assume that leadership will be forthcoming, not just in the American community but in the Pacific-Asia community. That is our basic subject tonight. We recognize that economic warfare will help no one, but we also recognize that these problems cannot be brushed aside. Nor can they be blamed on a single constituency. There's enough blame to go around. We had better start sorting these matters out.

That is why, incidentally, I have favored, for American-Japanese relations, a permanent nongovernmental, high-level, bilateral committee that would have a much wider range of authority than the so-called "Wise Men Group." It would not deal with immediate problems for the most part. Crisis matters are a function of governments. Rather, it would concentrate on the middle- to long-range issues affecting our relationship. I should think something rather comparable might be useful in the American-Korean relationship.

Mr. MORSE. Before I ask you to join me in thanking both the speakers this evening but also thanking all the people that contributed throughout the day. Let me express thanks and appreciation of the three sponsoring organizations to all of you.

[The conference concluded at 10:08 p.m.]

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